StrategicRISK

RISK innovation

ISSUE
04
SEPTEMBER
2012

Showcasing risk management maturity around Europe

United front: Are UK risk managers flying the flag for Britain?

Operating in an age of austerity

UK risk managers face more work in hard times

Risk managers working in the UK enjoy many enviable advantages. Their profession is well established in this country and is taken seriously at board level. And they have access to what is probably the most sophisticated insurance market in the world, with the support of some superb brokers.

Yet all is not well in today's austerity-led Britain, with economic difficulties in the present and great uncertainty over the future. Many risk managers are working under much more difficult conditions than in the past, with fewer financial or human resources. At the same time, their workload is increasing as their employers look for new sources of growth, often by expanding operations in overseas markets. Risk managers are also under greater pressure to mitigate risk more effectively in some of the more highly regulated sectors, such as finance.

This report examines the current state of risk management in the UK – the risks that most concern risk managers, the benefits enjoyed by those organisations that are close to achieving best practice in this area, and the ability of the UK's insurance market to support risk managers in these tricky financial times.

IN ASSOCIATION WITH
ZURICH®

THE BIGGER PICTURE
FOR RISK MANAGERS

The global economic gloom should not distract risk managers from providing a strong, consistent message about their value to businesses and boards

It is not really surprising that risk management has evolved to a fairly sophisticated level in the UK. This is, after all, a country that has led – and in some respects continues to lead – the world in the development of commerce and financial services.

Yet, as in many other countries, the most sophisticated approaches to risk management are still generally restricted to a minority of organisations. Elsewhere, the concept may be acknowledged, but it is often difficult to demonstrate that it is practised across the whole organisation.

Armoghan Mohammed, lead risk partner at consultant PwC, believes the difference in approaches to risk in the most highly regulated organisations in the UK, particularly those in the financial sector, and other types of enterprises or organisations, is still stark. The difference is perhaps best illustrated by the fact that companies outside the financial sector are much less likely to have a chief risk officer.

But at least, Mohammed continues, the way the risk management function is regarded by staff and senior management within those organisations does seem to be changing. "People now think risk management is about protecting the organisation," he says."Historically, there may have been a perception that it was another hurdle people had to go through. People are realising now that whether it's a Deepwater oil spill or a Toyota recall, it protects the bottom line as well. It's not a tick-box exercise. It's here to allow us to carry on generating profit.

"The role of the risk manager has been elevated – I don't think quite to the boardroom yet, but there's a lot more focus on this than there ever was before."

But is that a sharp focus or still a rather vague one? Nicholas Bailey, group risk manager at BBA Aviation and current chair of UK risk managers association Airmic, says he has some concerns about the "fairly disparate" nature of risk management in the UK.

"There are all sorts of people, organisations and third parties who think they do risk management," he says. "And they do, but we're all still groping around to try to coalesce the various risk management functions in a way that defines the professional requirements of the risk manager.

"There are people like me on the insurance [buying] side – accountants, lawyers, company secretaries – all doing risk management in their own field, but I don't see a leading force saying 'this is what the role is really about'. We have standards, but there's no unified approach. It's bad for the profession because we may not be seen as fulfilling an important function if we're not really working together."

Bailey wonders whether some type of formal qualification might help – so we could see chartered risk managers, just as we see chartered accountants, surveyors or insurance practitioners today.

He is not the only person expressing these sorts of concerns, particularly as they touch on the status of the risk manager within British boardrooms. Airmic has published several documents that discuss the problem of risk managers hitting their own version of a glass ceiling, preventing them reaching the highest levels of management in many companies. That's ironic because, as Bailey says, more companies are coming to understand how central good risk management is to corporate governance.

His view is that a chief executive is a company's true chief risk officer, weighing up the pros and cons of each big business decision, whether that is the siting of a new factory or acquiring another company.

> *'We're all still groping around to try to coalesce the various functions in a way that defines the risk manager'*
> **Nicholas Bailey**
> BBA Aviation

Julia Graham, chief risk officer at global law firm DLA Piper, former chair of Airmic and a current vice-president of the Federation of European Risk Management Associations (Ferma), also believes a professional qualification could help ensure risk managers are taken more seriously.

She is at the forefront of a new Ferma initiative that will consider the creation of a pan-European certificate of professional competence for risk managers.

Graham says a proposed new governance standard, which the British Standards Institution (BSI) intends to launch in 2013, might help cement the status of risk management in the corporate world. It will focus on effective structures, relationships and accountability, according to the BSI, and should support existing risk-related standards, including ISO 31000 for risk management and the BS 25999 business continuity standard.

Colin Campbell, head of risk management at the retail business Arcadia Group, suspects the discipline is taken much less seriously in some industries than it is in the more highly regulated sectors such as finance.

There are various reasons for this. In his own business, he says, many fundamental business risks are directly monitored by managers throughout the retail sector. "Many people in retail probably think of themselves as risk managers," he says. "It's a fast-moving business, so people are making fast-changing business decisions, certainly on a

Key points

Risk expertise tends to be concentrated on a minority of organisations and in financial areas

Economic problems have led to stagnation of approaches to risk management

Calls for a professional qualification system are being taken forward by Ferma weekly basis and sometimes on a daily basis, as they manage budgets and stock management. Our businesses are used to managing risk – and more so because of the fast-paced supply chains and the need to switch from supplier or manufacturer very quickly to meet changing demand."

The downside of this, he fears, is that retailers may sometimes fail to pay adequate attention to other risks that could be of just as much significance to the business, such as regulatory compliance or questions of ethical trading. "Those kinds of things are at the forefront of what retailers do but they're not seen as day-to-day concerns," says Campbell. "I have to bring them to the fore and make sure the business is addressing them, particularly in relation to legal management."

As with every other aspect of the business world, the practice of risk management in the UK has been subject to wider economic problems in recent years. Bailey says those effects have been played out in complex ways.

"There's less money around, so less enthusiasm to put in new processes – and risk management can be seen as a process," he says. "There's potentially less M&A work. There's less growth and in a growth environment the risk manager needs to be asked for their thoughts on a new factory and so on. When things are changing people do consider risk. When things are static or declining people don't consider risk so much."

But, he adds, there are companies looking to protect themselves. And one ever-present feature of the financial crisis, from the meltdowns of financial companies during 2007 and 2008 and beyond, has been publicly stated dissatisfaction with risk management processes of various kinds. The issue continues to crop up in the news in all manner of situations, from problems within the banking sector to phone hacking at News International. It all helps to give the concept attention in the nation's collective consciousness.

Aside from the basic risk of going bust during a recession, what are the main risks occupying minds in the UK's businesses and other corporate organisations today?

It's important to try to avoid generalisation. As Graham notes, a company's priorities in risk management vary significantly from business to business. "You might get the same top 10 risks quite often, but different sectors always order them differently," she says.

"Those priorities change according to culture and geography too. It depends on the sector they're in, the maturity of the risk management within that sector and the experience they've had."

Indeed, as she points out, "corporate and personal

memories are very short" and organisations are likely to be preoccupied by the latest big problem they have faced.

However, the background context within which an organisation is operating is also significant. "The context we're living in at the moment is financial instability," says Graham. "That influences your risk profile. Does it exacerbate your fraud profile or other financial risks? Does it make it harder to raise capital? Are companies economising on maintenance contracts?

"You should be looking not so much at individual risks but at the context in which those risks and unforeseen consequences are created."

Common issues still seem to crop up though, says PwC's Mohammed. He points to the three main categories into which risks are most often grouped: financial, operational or strategic. "Generally people focus a lot on financial because they can quantify it, a little on operational and hardly ever on strategic risks," he notes. "Do they look at what risks their strategy is creating?"

Many current concerns come under the "operational" heading, says Bailey. He cites risks related to the supply chain, along with the group of technology risks generally termed cyber risks. "Those are the key ones we're facing, either because of a lack of innovative insurance offerings or because the insurance has been withdrawn," he says.

Graham believes technology risks are becoming more problematic because many organisations find themselves pinched between what observers say is a growing threat from cyber attack and pressure to economise. "That's a »

» real dilemma," she says. "People are very sensitive to this, particularly with the new Data Protection Directive coming in. So you've got lots of pressures on information security."

A perennial theme is the need to manage risks related to the expansion of a business into new markets. "Emerging markets is a big area for many businesses, including mine," says Graham.

"It's about adopting the best principles for project management. My view is that you still need project management objectives, but don't judge everything in a market you don't understand by the standards of a market you do understand.

"So, for example, when it comes to insurance compliance, regulatory and legal compliance, you must take external expert advice. Don't make assumptions. Treat each territory as a new adventure, but be disciplined and make sure you're checking all the things you need to check."

> *'Treat each territory as a new adventure but be disciplined and make sure you check all the things you need to check'*
> **Julia Graham**
> DLA Piper

Bailey believes insurers and brokers are now providing risk managers with a better level of support when companies extend operations into new countries. But there can still sometimes be a worrying degree of uncertainty when it comes to ensuring the correct covers are in place. This is perhaps particularly the case with compliance, whether those demands come from the company's home country or the new country.

For Mohammed, it comes back to a failure to pay enough attention to strategic risks. "A lot of people think about expanding overseas in practical terms: engage the regulator, get treasury functions working and so on," he says. "But often the issues people have problems with later are fundamental: should the company be overseas at all? Can it handle a manufacturing chain extended over there?

"When people look at the risk register for going overseas, those are the key things they need to focus on," he continues. "You should do it on a risk-adjusted basis. I don't think people think about risk-adjusted returns. Or if they do, are they adequately adjusted for the risk profile of expanding overseas?"

It appears that the most important – and sometimes most painful – lesson for UK organisations seeking to adapt and prosper in difficult times is that risk needs to be high on the agenda in the boardroom.

In these circumstances, a higher degree of risk awareness may turn out to be a silver lining to the current dark economic cloud hanging over the country.

THE TOP RISKS

FORUM FEEDBACK

A recent *StrategicRISK* roundtable with UK risk managers identified some important themes that are causing concern among participants. These include:

1 Corporate governance rules

These include the new requirement to cover risk tolerance in annual reports;

2 Acceptance of risk culture

Participants highlighted difficulties of developing a risk culture within organisations;

3 New markets

Risks associated with expansion into new markets continue to be a concern. The potential danger inherent in emerging sectors remains a persistent worry;

4 Supply chain risks

Supply chain risks are a perennial theme with managers focused on how to limit exposure with improved continuity measures;

5 Financial risks

Financial risks – and credit default risks in particular – have become a more important issue for some companies trying to arrange long-term contracts with new partners;

6 Business interruption risks

Non-damage business interruption risks such as the Icelandic volcanic ash cloud still loom large in corporate memories;

7 Social media

Risks related to monitoring social media *[see Hot Topic, right]* were also cited as the number one risk issue in the 2011 Airmic member survey, with almost half the risk managers interviewed (47% of the 108 sample) saying this was among their top three most concerning risks. Some 37% cited non-damage business interruption risks, while 35% cited supply chain risks;

8 Data security

Some participants expressed concerns over a lack of clarity as to whether a risk manager or the IT department takes responsibility for these issues. This was also the fourth most commonly cited risk in the Airmic survey, listed in the top three by 34% of respondents.

Colin Campbell, head of risk management at the retail business Arcadia Group, says many commercial organisations have been alarmed by the damage (financial and reputational) suffered by companies that have lost customer data through cyber attacks.

"Cyber risk is the big unknown," he says. "The main source of risk is not really the risk of websites going down and e-commerce business lost, although that clearly is a concern. The main problem is loss of data and the impact that might have, particularly if you have operations in the USA, where the regulatory climate is such that this can be very expensive."

HOT TOPIC

THE THREAT OF SOCIAL NETWORKS

The development of social networking has led to big changes in many people's lives, including those of risk managers.

Arcadia head of risk management Colin Campbell says he and many of his peers are particularly concerned by the difficulties of monitoring reputational risks related to the spread of damaging material via social networks. A business might be targeted by a campaign group, for example. "Given the speed with which social media sites can pick up an issue and then move with it, monitoring that and keeping apace with that activity is a real problem," says Campbell.

"Sometimes it's difficult to know what to try and intervene on. There are things we can do in terms of our own sites and workforce, but there's not much you can do about third-party activity."

EXPERT VIEW

TOM RICHARDSON, HEAD OF CUSTOMER RELATIONSHIP MANAGEMENT, ZURICH GLOBAL CORPORATE UK

MANAGE SUPPLY CHAINS

The major concern for risk managers working for large organisations here in the UK is globalisation and its impact on supply chains.

As UK plcs have grown, their supply chains have developed. Previously, suppliers used to be located within close proximity to the business. Now this is rarely the case, and businesses are having to cope with the fact that supply chain structures have moved on dramatically.

The need to develop risk managers' thinking along with these changes cannot be emphasised enough. Their approach has to adapt and be flexible. Many organisations didn't consider the importance of the supply chain, but now attitudes are changing and risk managers are placing much more importance to the outcomes of these risks.

Because the landscape is ever-moving and becoming more complex, the way it is dealt with has to be different. Understanding and working alongside procurement has to be a key risk management function in business today. It needs to be understood that while financial objectives can be achieved through consolidating suppliers, there's also the potential to consolidate risk.

An innovative approach to supply chain management should be detailed and recorded somewhere in a format that can articulate risk both to those within an organisation as well as external suppliers. The real challenge is to corral all the information and structure it into a format that is usable and meaningful. While risk managers are unable to force decision-making, what they can do is provide the necessary information and tools to enable organisations to make better decisions.

The main lesson for businesses to take from the past 12 months is that they need to better understand the knock-on effects that supply chain disruptions can cause further down the road, and not just the impact that can happen in the here and now. The difficulty is that there are a lot of unknowns involved when attempting to calculate the long-term effects. This means that there are a lot of assumptions, and these are compounded further up the supply chain. This then increases the probability of mismatched expectations, leading to the greater potential for unsatisfactory outcomes for both the insured and insurer.

Therefore, the more that can be agreed upfront, the less potential for pain later on in the claims process.

WHY ENTERPRISE-WIDE MAKES MORE SENSE

Enterprise risk management strategies are becoming more widely and more effectively established as large companies – and large catastrophes – call the shots

Key points

ERM is seen as an important way of identifying and exploiting new opportunities

Embedding ERM in the corporate culture is regarded as a key milestone – and challenge – in a business

Black swan events are raising questions and prompting a change of attitude towards ERMs

The trend towards enterprise risk management (ERM) is as strong in the UK as anywhere else in Europe. A growing number of organisations have adopted the concept in recent years. But ERM in its true form – a complete integration of internal controls, compliance functions and strategic risk management – is still the preserve of a few large public sector organisations and some larger companies. UK companies to have won plaudits for their use of ERM include BT, Nestlé and Rentokil Initial.

There is still some disagreement over what constitutes effective ERM. "I'm not always convinced people know what they mean by it," says Julia Graham, chief risk officer at global law firm DLA Piper. "But in many organisations I'm sure it's always been there in some form. We also now have ISO 31000 and input from organisations such as Airmic, helping to provide the foundations businesses need to translate risk management into something that's wider, more all-embracing and systematic."

Most risk managers agree that a milestone for any organisation's ERM efforts is when the concept becomes truly embedded in its culture. But the way in which this happens can vary. Colin Campbell, head of risk management at Arcadia Group, believes his company has a risk culture. But he is quick to admit that the ERM practised at Arcadia might not look the same as that of a large company in, say, engineering or financial services.

Campbell says embedding the concept in the culture is the vital step and that the nuts and bolts of an ERM infrastructure need to be flexible. "Most businesses, even if they're large international conglomerates with many people involved, still have an evolving ERM programme," he says. "The risks change and people change."

One UK company that has achieved much in its use of ERM is the InterContinental Hotels Group (IHG). In May 2012, IHG's John Ludlow was named European Risk Manager of the Year at the *StrategicRISK* Awards. He has overseen an ERM infrastructure based on embedding a risk management culture where risk management processes are led by a global team with direct support from board level.

The company operates or franchises more than 4,150 hotels in almost 100 countries, so its risk framework has been tested in recent times by the natural disasters that struck various parts of the world in 2011, including the tsunami in Japan and earthquakes in New Zealand. It has also been affected by the political upheavals associated with the Arab Spring. In the background, meanwhile, it has needed to identify and manage the many risks faced by a complex, growing international company.

The IHG approach allocates responsibility for strategic, tactical and operational risks at different levels of the company:

- Senior managers in regional centres handle strategic risks, with some oversight from the senior executive level;
- The global risk team helps local project managers to manage tactical risks; and
- Operational risks affecting the company's hotels and franchises and associated ancillary services are managed at local or regional level.

A review process aims to identify key risks across all three areas and the chief executive is present at two dedicated meetings each year to discuss risk review and management processes. The company's audit committee also conducts an annual review of the risk management systems.

One of the most important aspects of ERM is that it can help organisations identify and exploit new opportunities. "If people are more risk-aware, they might be more aware of opportunities," says Graham. "It's making sure people are making better informed decisions. If you're really linking your approach to risk management to the wider strategy for the business, that's one way to create opportunity.

"Some companies are able to say how much money that has made them, particularly businesses with very high health and safety protocols or businesses that are very investment-intensive, where good risk management means you're only investing in what you need to."

She says it is harder for DLA Piper to quantify the value of ERM in this way, but she leads an enterprise-wide team in what is now the biggest law firm in the world with more than 4,000 lawyers in 30 countries. Graham's team arranges all the firm's insurance for all classes worldwide, aiming for consistency and the benefits of economies of scale.

She works closely with the chief financial officer to ensure their roles complement rather than conflict with each other. This kind of input has been a key factor in maintaining stability while the firm has continued to grow. "The fundamental thing for me is that risk is all about ensuring a business achieves its objectives," says Graham. "You're taking conscious, risk-informed decisions. That's got to be the biggest upside of doing it."

> *'Most businesses, even a large international conglomerate, have an evolving ERM programme. The risks change and people change'*
>
> **Colin Campbell**
> Arcadia

ERM has also proved useful for other businesses which, like DLA Piper and IHG, have expanded into new markets. Using the ERM framework has helped them assess the liability, political, commercial credit and financial risks that international expansion entails.

One constant theme for multinational companies today is the need to secure the global supply chain – illustrated so vividly by natural disasters during 2011. A sound ERM strategy can go a long way to protecting the global supply chains so many companies now rely on.

Yet if ERM is the new orthodoxy in risk management, there are some dissenting voices. PwC produced a particularly interesting paper in 2011, *Black Swans Turn Grey – The Transformation of Risk*, which looked at the challenge of developing risk management frameworks that can provide some protection against black swan events – unforeseen events that have a major, catastrophic impact. PwC suggests they merit their own risk category alongside known risks and less understood emerging risks.

The paper asked whether black swan events were becoming more frequent and considered whether ERM was a suitable approach to use when trying to protect organisations against them. It identified three shifts in thinking that were having an impact on some organisations:

- A concern that existing risk frameworks and processes were no longer providing the protection the organisation needed
- An observation that risk events were happening faster, with knock-on effects that spread quickly and could threaten the viability of the organisation; and
- A concern that too much time and money was being spent on existing risk management processes rather than on developing more flexible frameworks that would better be able to adapt to change.

The frequency of black swans remains an open question. The authors of the paper concluded that while ERM can be a highly effective means of protecting organisations against many different types of risk, it may not be as suitable for the task of providing end users with an understanding of the inter-dependencies between financial and operational risks. Nor might it help organisations assess strategic risks.

The authors advocated the creation of a more pervasive risk culture within organisations. Risk awareness and assessment should be regarded as part of every member of staff's job, they argued, and there should be a champion of risk management at, or reporting directly to, board level. This could be some kind of chief strategy or chief risk officer, providing the board with a more holistic view of strategic, operational and other risks, thus creating more new opportunities.

While some argue that this is what a comprehensive ERM strategy should already do, most organisations would agree that it is difficult to prove this in practice. "I think UK corporates are refocusing their attention on risk," says Armoghan Mohammed, lead risk partner at PwC and a co-author of the paper. "They've got a distance to go, but we're seeing much more discussion of the element of risk management as a protector of the organisation. But we need organisations to go on taking risks to help generate opportunities for growth."

Whatever the frameworks a risk manager tries to create – or is lucky enough to be encouraged to create by an employer – various factors will probably ensure that there will not be too many dull moments for them over the next few years. Indeed, opportunities for risk managers themselves seem »

HOT TOPIC

RISK MANAGEMENT IN THE FINANCIAL SECTOR

The context in which most people in the UK are most likely to have heard or read the words "risk management" during the past five years will have been a news story about one of the many recent financial scandals. From the 2007 credit crunch, taking in the collapse of Lehman Brothers in 2008 and various rogue trading or fraud stories – and culminating most recently in the Barclays Libor-fixing affair – risk management has been in the news. So although it has had a higher profile than usual, it has often been for the wrong reasons.

It is paradoxical that risk management is generally assumed to be at its most sophisticated within the financial sector, given these high-profile incidents. In addition, some of those working in financial institutions still regard risk management in a negative way – as a block on business and a bureaucratic source of delay.

The extent to which risk has also been used as a tool by regulators in the UK and beyond to impose capital adequacy regimes on these regions has not helped – even if you take the view that regulators are responding to excessive risk taking within a sector that has already damaged or destroyed many companies.

The failures of risk management in the financial sector could eventually produce more positive effects rather than providing another reason to pile additional regulatory requirements on businesses.

Improving practices, driving advances in the use of technology and developing more effective business processes and industry standards will help raise awareness across the financial sector. This will help workers regard risk management as a protector and facilitator, helping the business to identify and exploit opportunities as well as to protect it against incompetent or criminal actions.

Then, perhaps, fewer of those workers will end up in the headlines for the wrong reasons.

» certain to increase in parallel with the opportunities that their work creates for their employers.

PwC's Mohammed believes that risk management is becoming a much more attractive career option. "I think it's a great place to be for a career at the moment," he says. "There's a lot more focus on risk, and risk managers are moving into higher levels of organisations. It's probably the best time ever to move into risk as a career."


Julia Graham

UP THE LADDER

THE KEYS TO A SUCCESSFUL RISK MANAGEMENT CAREER

THE HARD WORK IS WORTH IT

Julia Graham is chief risk officer at global law firm DLA Piper, vice-president of Ferma and a former chair of Airmic. But she began her career in insurance, working for Zurich. At 20 she moved to General Accident, where she remained until her then husband took a new job in Kent. Graham took a new job working for Royal Insurance (since absorbed into RSA).

Here, she says, she benefited from "the best education in insurance you could get, probably as good as from any insurer in the industry – the way they trained their people was brilliant".

She stayed at Royal for 27 years, working in a variety of different roles and locations across the UK. Then she moved to a London office to become the company's first head of risk management.

Later, following the merger with SunAlliance, she became group risk manager for RSA, dealing with strategic and operational risk and compliance. "I was very happy there, but about eight years ago DLA Piper approached me through a headhunter," says Graham. "I came to meet them and they were inspiring. I loved working for RSA, but I took the job with DLA Piper and it was the best decision I ever made.

"Every day is different, I work with great people, and I've watched the firm grow with enormous pride to become the largest law firm in the world. It's hard work – lawyers work very hard, I work very long hours, but the days fly by and I love it."

KEY BENEFITS

The ERM programme at Intercontinental Hotels Group (IHG) has reaped rewards for the company in a number of different ways. By dividing the key risks, the company and its franchisees work in three groups – strategic, tactical and operational. By allocating and delegating responsibility for managing those risks to a combination of senior and local management, supported by a global risk team, the group has been able to enjoy a number of key benefits.

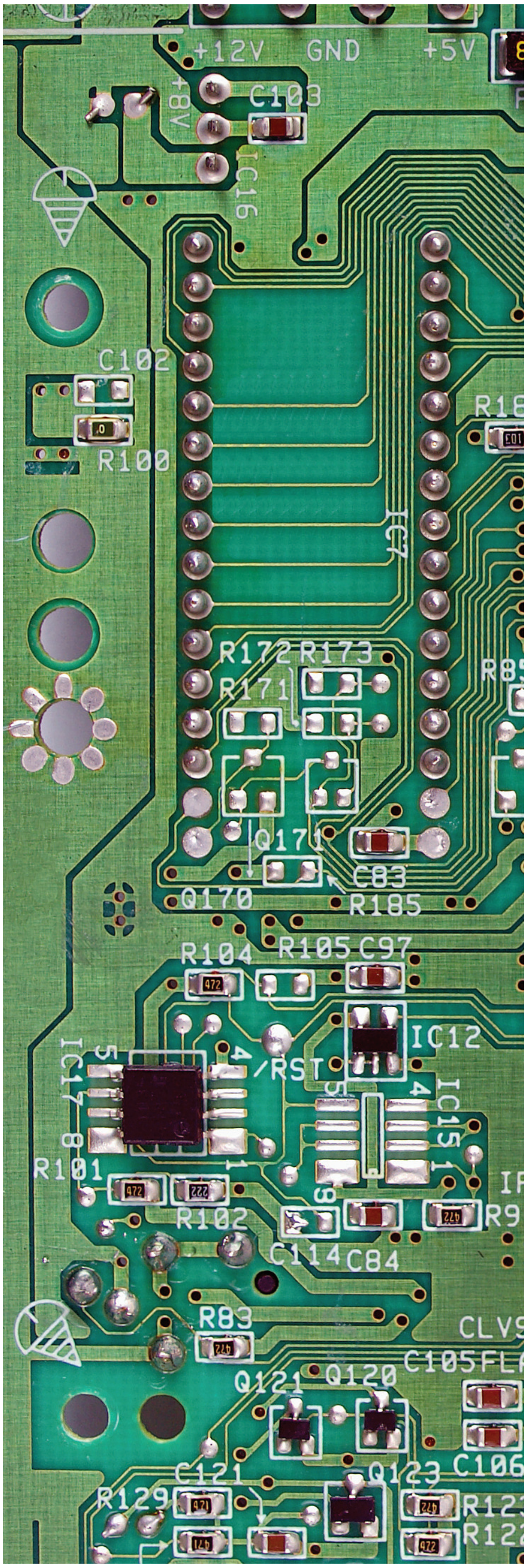
For example, the ERM framework has helped to:

1. Shield this international company from adverse financial problems related to the eurozone crisis – close monitoring of capital and cash has minimised negative exposure to unexpected currency movements;
2. Inform financial strategies that have ensured the availability of capital to maintain operations at IHG's existing hotels and support the development of new hotels and franchises;
3. Monitor and build upon the success of the hotel's internet operations by helping to determine optimum levels of resources to be allocated to online marketing functions – such as search, loyalty programmes and new consumer-facing web or mobile applications;
4. Ensure the security of corporate and customer data, thus protecting the company from the threat of legal, regulatory, financial and reputational damage.

> *'Every day is different, I work with great people and I've watched the firm grow with enormous pride to become the largest in the world'*

GIVE AND TAKE

The UK may have a sophisticated and established insurance sector, but its operators must be prepared to work with customers in a fast-changing world



The British insurance industry is one of the most sophisticated and technically accomplished in the world – but it's not always held in such high esteem by its customers. Some studies suggest grounds for complaint. In 2011, insurance governance specialist Mactavish published research highlighting serious problems in corporate insurance. Its study was based on interviews with more than 600 UK companies and more than 100 insurers and brokers.

The research concluded that disclosure and placement processes for major risks were inadequate. It cited excessive reliance on undocumented risk information and a failure to review loss scenarios or policy wordings as being among the worst problems. It revealed that 87% of insurance buyers did not understand the extent to which disclosure was their duty or the consequences of failing to meet this duty. Some 65% of respondents said they did not review the materials used to arrange their insurance.

The study reiterated familiar complaints: insurers were failing to keep pace with changing risks, but taking a tougher stance on claims. Nicholas Bailey, group risk manager at BBA Aviation and current chair of Airmic, spends much of his working life trying to meet the insurance needs of his company. He cites cyber risks and supply chain risks as widespread sources of anxiety among his peers, because of "a lack of innovative insurance offerings or because the insurance has been withdrawn".

"It's about taking proportionate risks," responds Malcolm Tarling, media head at the Association of British Insurers (ABI). "Insurers are there to reflect emerging risks, trends and concerns. Obviously, it can take a little time to ascertain the level of those risks but insurance doesn't stand still."

Willis UK retail chief executive Dan Wilkinson adds: "There is an increasing level of sophistication around the quantification of cyber risk, but the capacity is yet to follow." However, a report from Airmic in June indicated there has been a rapid development in the range of cyber risk insurance products. The problem, it suggested, is a failure by insurers and brokers to communicate news of these advances to buyers.

Another big cause for complaint is the frequency with which insurers' actions lead to disputes over claims and reservations of rights. "I buy a policy in good faith and we often get the impression they're trying to find circumstances in which they won't pay those claims," complains Bailey. But he adds: "Probably some insurance buyers need to take their share of the blame in terms of understanding what policy they've bought or what they disclosed."

Wilkinson responds on behalf of insurers and brokers. "If you look holistically at claims trends in the UK and at successful claims ratios, you'll see that 97% of claims are »

Key points

Customers continue to complain about changing risks and a tougher stance from insurers

Pressure mounts for insurers to communicate better on exposure and to advise on risk

PwC recommends insurer/broker partnerships with clients to improve profitability and cut costs

> *'The more that can be done up front to manage expectations, the better it will be if there is a claim'*
> **Candy Holland**
> Echelon Claims Consultants

going to be paid, without dispute, in a speedy manner," he says. "You are going to get the odd large claim that hits the headlines and becomes the exception to the rule. As an industry, we do ourselves a disservice by allowing people to focus on that. But the average operating ratio for commercial insurers is around 100%. That shows you how much is being paid out in claims."

Wilkinson believes brokers must take a share of the responsibility for ensuring clients make all necessary disclosures. Willis gets clients to sign off risk presentations before the broker goes to market on their behalf.

The 2011 Mactavish research revealed a dangerous lack of scrutiny and due diligence dedicated to insurance purchases by companies. While that might seem harsh to any risk manager who spends hours poring over insurance contracts, it is hard to argue with the course recommended in a paper published by PwC alongside Mactavish's study.

PwC's solution is to develop a genuine partnership between insurer/broker and client. It estimates that taking this approach could help insurers reduce combined ratios by 10% to 15% by improving loss ratios and increasing orders and retention rates. Brokers could boost profitability by 5% to 20% through improved placement and client retention, while corporates could cut costs by 5% to 20% through reduced premiums, losses and risk costs.

"Closer relationships are absolutely proven to reduce issues such as reservation of rights," says Wilkinson. "But then you get into the economics of managing that relationship. You can only apply capital or time where you're getting an appropriate return."

Eddie McLaughlin, Marsh's managing director, strategic risk consulting for Europe, the Middle East and Africa, believes there has been progress in this area. He highlights other steps that can help, such as a claims preparation clause which means the insurer pays for a claim to be prepared in a professional manner.

Candy Holland, managing director of Echelon Claims Consultants, believes Airmic's work in this area in recent times on behalf of risk managers, such as campaigning on reservation of rights and publishing guidelines on how insurers should treat claims, has had an impact. She also points to efforts by various client industry associations and service providers to bring insurers and clients together.

Holland extols the value of exercises such as the policy stress testing that Echelon organises, walking insurers and their clients through hypothetical claim and loss scenarios. "The more we see that happen, the less you will see claims disputes occurring," says Holland. "The more that can be done up front to manage expectations and make sure the cover is there, the better it will be if and when there is a claim. Initiatives like that help bring these parties together. In the past the claims person at the insurer never met the insured until they had a claim."

Where such relationships could prove particularly beneficial is when companies seek to extend operations overseas. Marsh's McLaughlin says brokers need to be able to supply answers to basic questions, such as what cover is actually needed in a particular country. They should also be able to advise on key risk areas, such as non-damage business interruption and the supply chain, and offer in-depth local knowledge.

"If you're expanding into parts of eastern Europe, Russia or parts of South America, for example, there are cultural aspects you need to be aware of," he says.

"In South America the compliance processes can be very complicated. Because there are regional governments, laws may be different in different parts of the country, so compliance there may entail more than just reading the legislation."

A new global compliance database that Airmic is creating, with the support of Aon, Marsh and Willis, will help. It will cover compliance aspects of global programmes, including placement structures, contracts, claims notification and payment restrictions, and the consequences of non-compliance.

Bailey still has doubts about the ability of the insurance industry in general to meet these needs. "Insurers are getting better at it and brokers have a better understanding of what the exposures are," he says, "but each insurer is different.

"As the buyer, I am struggling still to get a position where I can place the cover in a given country and be fairly confident with the decisions that we've made if I'm investigated by a local regulator. I've had different answers from people working inside the same insurer about what the exposures are."

> *'The average operating ratio for commercial insurers is 100%. That shows you how much is being paid out in claims'*
> **Dan Wilkinson**
> Willis UK

If the UK and the London market can offer access to sophisticated products, some British insurers and brokers need to become a little more straightforward in their dealings with the client.

GOVERNANCE CHECKS

SEVEN QUESTIONS EVERY BOARD SHOULD ASK – BUT RARELY DOES

1 Has the company analysed the impact on capital adequacy if an insurer were to question a major claim?

2 Are we certain that the business complies with all the demands that insurance law places on the corporate buyer? Do those responsible for disclosure and compliance understand the consequences of failing to comply?

3 Does the company approve all materials used to place its insurance policies, and has explicit agreement on which documents together constitute the insurance contract?

4 Have specific contractual amendments been agreed with brokers and insurers to reduce the insurers' right to rely on the Marine Insurance Act 1906 in its pure form without any available recourse?

5 What audit takes place of insurance placement procedures (both internal and by the broker)?

6 Have the most foreseeable major loss scenarios been explicitly disclosed to insurers and reflected in policy wordings to ensure they are covered?

7 Are agreed procedures in place for response to large losses to avoid delay?

Source: Mactavish

EXPERT VIEW

VINICIO CELLERINI,
CHIEF EXECUTIVE OFFICER,
ZURICH GLOBAL CORPORATE UK

INNOVATION THAT WORKS

Insurance companies like data – the more data the better. However, innovative solutions can be so new that there is little data available to work with, which means insurers find it harder to model and price these solutions. This isn't to say we shouldn't be innovative, but it does pose challenges.

Zurich's supply chain solution has evolved by engaging with the customer base and adapting original thinking to improve its performance. We took a customer-driven approach to this by addressing weaknesses in the market-standard property solution.

Zurich's investment in supply chain insurance was clearly the right thing to do – the Japanese earthquake and Thai floods have highlighted the need for such a solution. The global ramifications of the Japanese quake and its effect on the inter-connectivity of the corporate supply chain have also led more people to appreciate the importance of the issue. Between 25% and 30% of the world's hard-drive discs (HDDs) are manufactured in Thailand. The aftermath of the disaster left many plants closed for two to three months and prices of finished discs soared.

Here at Zurich we're also concentrating on looking at outcomes as well as triggers. Research is always carried out on the main drivers surrounding stakeholder value. Recently, much of this has revolved around brand risk as opposed to physical insurable risk. Our brand and repair solution is one example – if an insured incident takes place that adversely affects a brand's share price, the policy pays for proactive work to repair the brand.

Obviously a solution like this depends on greater upfront due diligence and requires a much more intensive underwriting process. Triggers, for example, must be very, very specific indeed. Also, the handling of a claim needs to be brand consistent.

IN ASSOCIATION WITH

ZURICH