StrategicRISK

THE PRESIDENTS' ROUNDTABLE
EVOLVING RISKS

Sponsored by:

Presidents' Roundtable Participants

Marie-Gemma Dequae president, FERMA, chaired the discussion

Franck Baron, board member, SIRM

Antonio Fernandes, board member, APOGERIS

Hans Gorrée, president, NARIM

Ulf Jonsson, former chairman, SWERMA

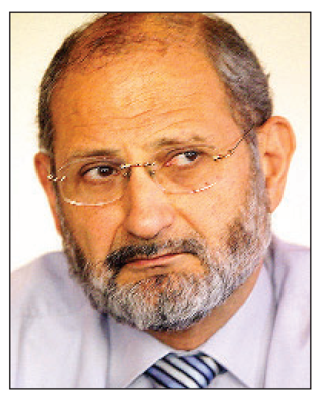
Florian Mueller, General manager, ACE Switzerland

Günter Schlicht, executive director, DVS

Kadidja Sinz, head of financial lines for continental Europe, ACE

Tatiana Shemyakina, executive director, RusRisk

Geoff Taylor, chairman, AIRMIC



Michel Yarhi, president, AMRAE

EVOLVING RISKS

The global business environment is changing – and companies need to adapt their strategies accordingly. But the comparatively short-term focus of management boards and national governments means that generally the implications of long-term risks are not being taken into account despite the fact that dealing with them now, rather than in the future, would actually save overall costs. That is one of the clear messages that came from this year's Presidents' Roundtable.

Two of the particular focuses of this discussion were energy/commodity risks – scarcity and pricing volatility - and the effects of globalisation. It was generally agreed that meeting tomorrow's demand for energy at an affordable price and without increasing environmental pollution could mean an unpalatable and potentially high risk solution – an investment in nuclear power plants.

Globalisation, in particular, outsourcing, has produced some unforeseen consequences. For example, outsourcing manufacturing to developing countries where costs were much lower was seen as the optimum answer for many European companies. And it looked as though it was adding flexibility because, of course, you could always change your supplier.

But, as one participant in this discussion pointed out, it's not that easy, once you get to a certain size, to change your supplier in a global supply chain. And if you're asking your suppliers to invest in meeting your international corporate social responsibility standards, which involves them committing some of their capital, they want some guarantee as to longevity of contract.

Both of these risks – energy and outsourcing – can probably be summed up by the word 'interdependence'. Some European countries are going to have to rely on their neighbours to supply the power they need. And major companies are outsourcing to the same smaller suppliers in countries which may have different national priorities, presenting the risk of government intervention, or may even be in areas which could be prone to natural catastrophes. There's a whole lot of risk there!

Finally, our participants looked at insurance issues and particularly contract certainty. The message here was that the insurance industry tends to get the blame for late policies but the risk manager is the starting point. If it is a goal to have your policy wordings confirmed on the day of inception/renewal, you need to begin negotiations early. Overall, it is clearly about planning renewals and making sure the interaction between risk managers, brokers and insurers works in a most efficient and productive manner. Some insurers clearly must improve in certain areas, providing customers with complete wordings in due course once both parties have agreed on all terms.

This was a lively and informative discussion, taking a holistic global view of risk.

Sue Copeman, editor, StrategicRISK
Florian Mueller, General manager, ACE Switzerland
Kadidja Sinz, head of financial lines for continental Europe, ACE

EVOLVING RISKS

> **Everybody is talking about Middle Eastern oil, but in Canada there is an enormous field.**
>
> **HANS GORRÉE**

MARIE-GEMMA DEQUAE: The topics that I propose we discuss are the evolution of energy and commodity risks due to scarcity and price fluctuations and what the effects are on our business and risk management activities in risk management. Then perhaps we could consider the ever more rapidly changing business environment and the impact of globalisation, and close with a follow-up on contract certainty and transparency which is more on the insurance side.

I do not know if any of you have read this year's World Economic Forum report on global risks. I found this quite interesting and the oil price shock/energy supply interruptions are mentioned among the global risks. We are seeing very high use of energy and also of commodities, particularly due to the Chinese increase in activity. The question here is: what will the future bring? Is that something that you look at as a risk management association or more individually within companies?

HANS GORRÉE: I saw a presentation from one of our directors from Canada, where Shell have a mining programme. They have millions of cubic metres of sand, full of oil, and there are so many resources there that that field in Alberta can handle the oil consumption of the US for 100 years. I think that is very interesting and it has political implications. Everybody is talking about Middle Eastern oil, but in Canada there is an enormous field.

MARIE-GEMMA DEQUAE: It is true that, as the prices are rising, the higher cost of drilling deeper is becoming economically acceptable, but that is only in relation to oil. If we look at the supply of gas then we get into other risks. Supplies may be available, but gas has to be transported overland, and there may be some political issues there. Countries have to be very attentive to having an adequate energy supply to meet their needs. In fact, the World Economic Forum is suggesting the appointment of country risk officers to deal with these global macro-risks.

ANTONIO FERNANDES: In the area of energy, there is an interesting question arising in Portugal, that the majority of the European countries do not face, and that is whether we should be considering nuclear energy or not. We do not have nuclear power stations at present. But it is clear that the energy cost in terms of electricity will rise. Every business should be aware of that, and in our group there are some concerns. We do not know how the insurance market would react to that and whether they would change anything in their contracts. I would say that the majority of the population is not in favour of nuclear power, but we are concerned about energy scarcity. It would be very difficult for us, as a small country, to invest in nuclear power on our own.

KADIDJA SINZ: We had a recent conference in Switzerland where global warming was discussed and that very point came up. It was also shown that countries were not independent enough in their energy supplies, so that they would be dependent on decisions made elsewhere. Switzerland was a very specific example of that.

HANS GORRÉE: There was an enormous problem in the European network of distribution of electricity recently when some of the systems went down in Germany, and Holland and Belgium did not get enough electricity.

MARIE-GEMMA DEQUAE: It was due to human error so no recourse was possible.

FRANCK BARON: Going back to the risk management aspect in corporations, is this kind of risk on the radar of your top management and does it have a bearing on the way you are looking at your enterprise's management of costs?

GEOFF TAYLOR: I guess it depends on your industry. My own organisation does not really make anything, so it is probably more important for us to understand how well China is serving its energy needs, because that is where most of our products are made. I do not think management have really considered this at all. To be honest, I think there is an element of, not denial, but a going back to that entrepreneurial spirit that says: 'We will find energy somewhere.'

ULF JONSSON: In the Nordic countries it is certainly an issue that is being discussed very high up on the agenda, because we have so much industry that requires a lot of energy. The company leaders are demanding to know what the future will give them in terms of energy prices, so they can decide where they are going to invest. Energy demand is certainly a big issue. They are building one new nuclear plant in Finland, and are already talking about another one.

FRANCK BARON: Belonging to the chemical industry, which is one of the biggest users of energy around the world, although energy and commodity prices are part of our considerations when assessing likely impacts of risk for the company, this area is not one of the top risks for the organisation. I am not saying that is right or wrong, but that is the way it is managed.

GEOFF TAYLOR: Is that because it is considered short-term?

FRANCK BARON: I think so. I also think that, even if we are a huge spender of energy, it is still not seen as a major cost item of the company. On top of that, what we are missing is, let us say, the corporate social responsibility part of it, which is if a company wants to be seen as a good citizen, etc, you need to announce the fact that you are taking care of things like the environment.

MICHEL YARHI: The problem today is that the price of the energy has not reached the highest level. That is the reason why top management says that it is not a real issue. It is a problem for individual countries. In the current French elections, candidates are talking about whether or not to develop nuclear plants. The question is: do we have to be completely independent for electricity? At a corporate level, it is very difficult to have a real view and know what to do, when the country itself does not even have solutions. Even if a chemical or car manufacturing company says that it wants to reduce the amount of energy it uses, it cannot do it because its machines need a certain quantity of electricity. If the price is very high, a company will not reduce the number of cars it makes because of that. It will just increase the cost of the cars.

GEOFF TAYLOR: Another element that may come in here is that, although it might seem to be rapid, in fact this risk is changing over a longish period of time. So there are two factors that come into play. One is that a lot of boards only focus on the next set of results, so something that might happen in ten years is probably not on their agenda. Second, as you say, you adapt over time. If the price of one of the commodities you need goes up, then you increase the price of your product, and consumers will pay it or they will not pay it.

ANTONIO FERNANDES: But if we are talking about countries, the result there is that you can lose some competitiveness in your business sector, and that, I think, is the issue. If the environment in which you are operating loses some efficiency, you can lose efficiency yourself. And if your competitors have different cost structures or benefit from other kinds of environment, they can outperform you.

KADIDJA SINZ: We are approaching the point where companies are moving towards sustainable development and other elements like that, and some types of energy are more polluting than others, or leave more of a footprint for the future. What type of pressure will that put on boards and disclosures and investment strategies of the future?

ULF JONSSON: Certainly, in Sweden there has been a big discussion around nuclear power for many years. It is becoming very popular these days. Even the 'greens' have accepted that nuclear plants shouldn't be dismantled.

GÜNTER SCHLICHT: We are not there yet in Germany on the surface at least. Under the surface certain things are moving, but the political attitude remains the same, with the consequence that Germany might depend more on French nuclear power than some people might want.

MICHEL YARHI: It is true that if one country has nuclear power and does not have to rely on gas or oil, it may be able to manufacture more cheaply because the price of nuclear electricity is less high. At present, we are in the hands of those countries that have oil and we have to go along with them and their political points of view.

FRANCK BARON: But even if a country is completely independent as far as energy is concerned, there are a wide number of goods that rely on oil-based products, like plastic. So you will still have a very significant portion of your industry that is going to be impacted by this.

MARIE-GEMMA DEQUAE: Another point is that if you look at countries like China, they may, at some time, start to apportion their energy supplies, giving priority to personal consumers. Your energy supplies may be curtailed so that you cannot produce there any more. While a country may be energy independent, within that country there may be political priorities. And, with the impact of things like climate change, industry may not come first. It is good to give people priority, but at that moment the long-term caves in to the short-term. In the developing countries, the culture is different and how business is treated is different. So, things may evolve there that affect your business more rapidly than is the case in Europe.

MICHEL YARHI: At the end of the day, the real problem is: what is the image for the future? If we consider that the main issue is economical, we have to do what we need to ensure our country produces the necessary amount of energy. If we consider that societal risks are the main issue, nuclear plants represent a huge risk and, remembering our children and grandchildren, we have to decide whether we are happy to take that risk. Unfortunately, the alternative environmentally friendly sources of energy, from the wind and sun and so on, are not developed enough to allow countries independence through these means.

FLORIAN MUELLER: There was an interesting study in Switzerland done by Axpo, which is one of the leading power generating and producing companies, essentially analysing what the future would be in 2020 in Switzerland, in Europe and globally. Even with a huge investment in alternative energy, it seems there is no way around nuclear energy.

ULF JONSSON: Sweden closed down a nuclear power plant, but then imported coal-produced energy from Denmark, instead. I do not know if that was a better choice, but it was outsourcing the problem.

GEOFF TAYLOR: It is great to have energy independence, but, actually, it might be acceptable to say that we trust our neighbour to become our supplier. If you are in the European Union there is an element of reduction of risk in that, in that France is not going to turn off Germany's lights. And it saves you from the risks associated with having a nuclear power plant on your territory.

MARIE-GEMMA DEQUAE: You have to look at where the nuclear power plants are built. They are built in France near the Belgian border.

MICHEL YARHI: And the Swiss border and the German border.

While a country may be energy independent, within that country there may be political priorities.

MARIE-GEMMA DEQUAE

GÜNTER SCHLICHT: So at the end of the day, you have spread the risks!

FRANCK BARON: I found Geoff's first comment very interesting. When you are discussing risk assessment with the managers in your company, how do you get them really aware of the long-term killers, the long-term show-stoppers of industry? It is probably one of the biggest challenges for risk managers.

For instance, one of the biggest challenges for me is supply of water and that's a big issue in some countries around the world. But it's very difficult to get managers to address that type of long-term risk.

TATIANA SHEMYAKINA: The problem of getting your message across to the top is not only a western one. In Russia, we're increasingly looking to design risk management solutions probably due to an increased understanding of how risk management features as part of overall company development strategy rather than just being an insurance tool. Effective risk-focused approaches help improve a company's financial stability. And now businesses in Russia are generally choosing to manage large risks on their own and outsourcing by contrast is popular only for insignificant hazards. The demand for expert advice and consulting service in this field will also grow. Interestingly risk management consultancies have been booming recently in Russia.

Many Russian risk managers complain that company heads frequently underestimate the need for an effective risk management process. In many companies, risk management expenses are not listed as a separate item on the balance sheet. So there still remains a great deal to be done for risk management to work efficiently in Russian companies as a while.

MARIE-GEMMA DEQUAE: Would anyone like to add anything before we move to the next topic?

MICHEL YARHI: At present, all the available sources of adequate energy have their own disadvantages. So there are risks everywhere, and we do not have a real solution. We have to choose between two bad solutions.

HANS GORRÉE: In Holland, my company has been looking at energy from wind and sea, and windmills on the sea. We have windmills on land but now also on the sea because this is more economical. In the area of Rotterdam, there are a lot of windmills but 50% do not work. Do you know why? It is because companies are buying cheaper oil, and if they can buy cheaper oil they don't want to use the windmills.

In Portugal, there has been the quite famous Archimedes project which tries to use the strength of waves to generate energy as a way of producing electricity at a very low cost.

MARIE-GEMMA DEQUAE: So there are risks and opportunities.

GEOFF TAYLOR: The history of human endeavour generally shows that we find a way when adversity strikes. Whether that means suddenly turning on all the windmills, and all the solar panels across New Mexico or whatever it happens to be, someone will find a way to generate more electricity in the short-term. It may cost twice as much as planning a long-term strategy, but that is part of politics. Generally, in democracies, governments change every four or five years, so they are not likely to propose spending billions of dollars on a 25- to 50-year project.

MARIE-GEMMA DEQUAE: It is something that will have to be taken into account in a globalised company where new projects are developing, and the risks of supplies should also be assessed. Franck, you were talking about water. It is true that the cost of water in Africa is much higher than the cost of water in New York and that is one of the most important potential risks in the future. Is that something that is affecting your company?

FRANCK BARON: There is a kind of club comprising risk managers from the European chemical industries, and we discussed this fairly recently. Corporations are definitely not powerful enough to change things on their own, but you can do some things to at least master part of the problem. It is true that those companies that have begun to put a real sustainability programme in place and are trying to be as environmentally friendly as possible, first of all look at taking care of the water they are using. That means the factory using it as economically as possible.

On top of that, on a mid-term basis, we need to look at how to change the industrial process to reduce the consumption of water. This is not easy, going back to your point, Geoff, because for the time being there is not a strong financial pressure to change things, but at least we are looking at this. If you want to demonstrate that you are a 'green company', you put some resources into thinking about these kinds of things, and I think we have some very interesting projects in this area.

Going back also to the point mentioned by Michel, with water the problem is that there is no way we can be independent. We are going to be connected with other countries.

MARIE-GEMMA DEQUAE: It is true that the fiscal system can drive companies to a better use of water by putting a tax on water, and, certainly, polluted water. In my company, we have been working for more than ten years on a whole system of recycling water, and minimising the use of water in the process, and that was partly driven by tax incentive issues. If there is a fiscal, financial drive to do it, it is always easier.

MICHEL YARHI: We do have to take into consideration, of course, both the fiscal and reputation aspects. In the case of listed companies, if they are considered to be 'green', they are likely to attract investment in their shares, so the share price can grow. If they are not considered 'green', it may drop. As it is in the interests of management to have a healthy share price, this is one way of putting pressure on management. Socially responsible investment is more and more important so this is an issue for listed companies.

ULF JONSSON: That's true. I have attended several meetings where investors ask things like: 'How do you treat child labourers? How do you treat your workers in Mexico?' It is certainly an issue, and if we do not give the right answers it is in the morning's newspapers.

MARIE-GEMMA DEQUAE: Perhaps we can go to our next topic. Supply chain risks are certainly important for producers. Business is changing more and more rapidly, in and outsourcing is also evolving, and I'd like to have your thoughts on that.

GEOFF TAYLOR: The business model that we have has really been outsourcing from day one. That was our original business model, and it has become very popular. So you would think that we would be very sophisticated in

Socially responsible investment is more and more important

MICHEL YARHI

this area but that does not necessarily follow through, because there has been so much change. Even as we speak changes are happening that nobody could predict.

As you grow and get to a certain size you do not have flexibility in your supply chain, and that makes your continuity and crisis management really critical. In theory, we could just change supplier but it's not that simple in a global supply chain. So, actually, what we have created are some incredible dependencies in business that probably were never planned, when we originally thought we were creating a lot of flexibility. It is a dichotomy from what was intended.

I think, like most businesses, we look at the critical products and make sure that there is diversification of sourcing, but there are bottlenecks. The bottlenecks have to be addressed, and some of that has been done.

MARIE-GEMMA DEQUAE: Are changes in laws or regulations a factor in the supply chain? I am thinking of Chinese changes in regulations.

GEOFF TAYLOR: I have not seen that in China but the one thing we did see was a change in Turkey, where they decided to put tariffs on certain footwear with leather uppers, and that changed completely how the game was played. Then it comes down to lobbying in government affairs, and I am sure that all of our organisations engage in something along those lines.

ANTONIO FERNANDES: If you are a company that is supplying consumer goods, you cannot avoid being sourced by China. I think that is a big change for the company as it is putting the operations on the other side of the world. Of course, this brings new risks, but it is a new opportunity, and my concern is whether the company really understands the full nature of the risks. Are they really addressing the right questions in terms of this sourcing, because it is dramatically changing the business model the company is now operating? This is not a new question, but it is not always being answered.

GEOFF TAYLOR: That's a very interesting point. With hindsight, would we have made all the decisions we did about outsourcing and supply chain if there had been risk management 30 years ago?

ULF JONSSON: There is the well known case of Ericsson and Nokia when a supplier of components to both had a serious fire. Ericsson handled this badly while Nokia focused on alternative sourcing and came out much stronger in certain markets than they ever had been. It is a very good example of knowing your risks and knowing your suppliers.

FRANCK BARON: A few months ago, I was visiting the operation of our IT outsourcing company in Bangalore, India, and they had a kind of 'Hall of Fame', where you could see all of the names of their clients. I felt that there was a major issue here because if they had a problem, large companies all over the world would have IT disruption problems. That is something you have to take into consideration. The problem is: do we have alternative solutions to that? I am not sure.

GEOFF TAYLOR: One of the things that globalisation is bringing is huge systemic risk that was not there before, because we are all going to the same suppliers, whether it be data, telecoms, back office, shipping, airfreight, energy. The consolidation means that we have created these huge risks, and we see it even inside the stock markets. Years ago if one stock market fell, all the others would not be too worried. Now, one blip somewhere, even in Asia, and America wakes up with a headache. It is incredible how the interdependency has happened, again an unintended consequence. We thought we were making things more efficient and better, but we have created systemic risk for all society.

KADIDJA SINZ: Systemic risk is the most difficult to handle from the insurer's point of view, but at least understanding where it is coming from and where it will hit allows for some mitigation. Systemic risk identification is a key element of that.

HANS GORRÉE: We cannot really manage it.

FRANCK BARON: You cannot manage it, but at least as risk management professionals we have to ensure that our corporation is aware of systemic risks. Just because you cannot manage them, it doesn't mean that you are not supposed to flag them to ensure that you have a follow-up that is a global one. At least you will be prepared.

KADIDJA SINZ: Maybe then it will bring to a discussion certain things you feel, probably, you might optimise short-term, if you see that the systemic impact will be bigger than the short-term advantage you are getting. By realising that you might make some other allocation.

MARIE-GEMMA DEQUAE: I think we find that in every business decision the risk aspect should be taken into account. I was reading an article in which a lot of writers in management theories are proposing quite interesting changes in management, and we see that globalisation and everything that we are seeing today is a result of some of these management theories. I think as a risk manager, or as a group of risk managers, we should be aware of these changes, and perhaps analyse these theories and give a risk management reaction to it. Perhaps for the future we could avoid these more systemic risks by bringing these new market or management theories into practice.

FLORIAN MUELLER: In some cases you may have to avoid certain activities if you really cannot take the risk.

MARIE-GEMMA DEQUAE: Evaluating a new activity from the risk aspect has to be embedded in the decision. Sometimes, the more strategic decisions are not really fully risk-analysed.

FRANCK BARON: Another trend that is interesting my company is the B2B aspect, where we are supplying to end-consumer companies. This is one of the major constraints that we have in terms of risk management. You have to follow your clients. They go somewhere and you go there even if it is not part of your strategy. This goes back to your point, Geoff, about the stock markets. It is like everybody is more or less doing the same thing. You cannot go against it, or it is really difficult to do it in a very different way. If you are supplying the Proctor & Gambles and the Unilevers of the world, the business model applies to everybody including the suppliers.

FLORIAN MUELLER: Do you have experiences with in-sourcing? Have many of you been outsourcing for years services that you found to be critical to your business or

You have to follow your clients

FRANCK BARON

In some cases you may have to avoid certain activities if you really cannot take the risk.

FLORIAN MUELLER

found that outsourcing did not really fulfil the value proposition so you sourced something back?

FRANCK BARON: We had this experience when we hired someone who had some brand new ideas and we went along with these. Then we realised that maybe part of the changes was too extreme, and that it was not the right thing to do for a company like us. So we are reversing some of that – but we had to ask the person concerned to leave the company. It is very difficult for companies to be a learning company and to be strong enough to say: 'OK, we made a mistake there, we have to change it', especially if the same people are around.

FLORIAN MUELLER: Some managers would rather stick to their mistakes, and not lose face.

GEOFF TAYLOR: It is very strange that in our society we teach our children at school not to make mistakes, and actually it is through mistakes that we learn most. We set up a culture of avoiding accepting failure or mistakes, and a culture of explaining away mistakes, perhaps by something happening that was out of our control. We do not have a culture of saying that it is not actually a problem to make a mistake, and that we learnt a lot from it, and that that will benefit us in the future. Certainly our society is not tolerant of mistakes in practice.

MARIE-GEMMA DEQUAE: It depends on the company culture. Some companies may have a culture of seeing mistakes and trying to repair them without immediately getting rid of people. And that creates a very quickly reacting company.

GEOFF TAYLOR: I think it can work. Software is a great example. How many software companies, including some of the largest, put out products that do not work 100% and constantly fix them all the time? I suppose that relatively speaking that is cheap to fix, but if you build a plant at a high capital cost, and then it does not really do what it is supposed to do, it is hard to fix that problem.

MARIE-GEMMA DEQUAE: Yes, at that moment you have to take hard decisions. As you say, it can happen when a new manager is brought in who does not know the culture of the company. He makes quick decisions and that can be dangerous.

We have had the situation where we bought a company and then decided to sell it and hire the services back. It is easier to negotiate in that situation because you know the people and it could be better than hiring people from outside.

ULF JONSSON: How do you see that from a risk perspective? What was the change?

MARIE-GEMMA DEQUAE: In fact, it was externalising an internal risk, and in negotiation I really was asking for a good contract with good liability provisions.

ULF JONSSON: It is a very positive factor that you were part of that discussion in the first place.

MARIE-GEMMA DEQUAE: Yes, I am involved in all mergers and acquisitions, and all sales of companies because this is the time when the risk environment is changing. You have to look not only at your existing risks but, in the case of an acquisition, what is coming in. That is the most important thing. If it is a new company in the same business as you, it is easier to evaluate. If it is a new activity, it is more difficult but we have some quite good procedures to analyse these risks.

ANTONIO FERNANDES: When you are either acquiring or selling a company, the risk always exists. The question is: where are you putting it where it will be better managed? Who is the best entity to better manage that risk? Is it within your own management structure, or is it best managed somewhere outside your management control? Sometimes I think those kind of questions are not really addressed. If we outsource IT services, the risks will always exist, but are we the people who manage it better than them?

FRANCK BARON: Outsourcing is not about transferring risk.

ANTONIO FERNANDES: Sometimes people only think about the return from outsourcing, not the risk associated with it.

MARIE-GEMMA DEQUAE: If someone is producing something for you, you have to be aware of how that production is organised. You not only have to visit your own plants, but also those of your outsource companies.

GEOFF TAYLOR: I agree with you, Antonio. If somebody is better able to manage that risk, then probably they will deliver the service cheaper than you can do internally, because that is what risk is about. If you have your own internal IT infrastructure and somewhere something goes wrong, that is all you have got, whereas if you outsource to a specialist company it will have all of these other resources with qualified IT technicians on-hand all around the globe. So it can probably fix the problem quicker. That is what you are buying.

FRANCK BARON: For me, supply chain risk is a tremendous opportunity for risk managers within companies. It is a way to convince management that having a good degree of resilience and managing continuity is not just annoying stuff that we have to do within the company, but is something that we can sell to our clients. We say: 'If you work with us, if we become a critical supplier for you – which is the golden goal for a company like mine – it is going to be a safe relationship, and a fruitful relationship for both of us.'

This is where we have windows of opportunity to sell risk management as a commercial leverage, as something that is positive, and not just annoying or negative.

FLORIAN MUELLER: Is it a real issue for you also when you select outsourcing partners to check on their ability in emerging markets to comply with laws and regulations? Their experience in this field can become critical, I think, to long-term success. Also, to what degree are you accountable? Do you outsource a large amount of your business? How much ownership do you have?

GEOFF TAYLOR: I think that goes back to corporate responsibility. If you are a responsible citizen, then you make sure that those outsourcing partners comply with labour laws, with environmental laws, with all of those things. But cynical companies might see it as a competitive advantage to outsource something so they do not have to worry about, for example, environmental compliance in China because it is not their business. They can absolve themselves in a certain way.

Perhaps major brands do not do that because they have a reputation issue. But there are other companies that may be in a different position, perhaps suppliers of suppliers, and that creates a different challenge. Major brands have to question whether they need to go even further down into the supply chain to do all of that analysis as well, which then raises the cost.

FRANCK BARON: It is not just about compliance with national laws and regulations. There is compliance with international standards as well. If you are a company with a decent international reputation, I think it's even more tricky to ensure that your suppliers match your international standards.Your standards are going to be a little bit higher than the local regulations of countries like Indonesia, China and so on. That is the issue.

GEOFF TAYLOR: That also changes your responsibilities. For example, if you go to a supplier and say: 'If you want to be our supplier you need to have waste water treatment' they may say: 'Fine, it is going to cost $20m to install a waste water treatment plant. Are you going to guarantee that we are going to be a supplier to you for the next x number of years?' Of course, you were not expecting when you outsourced to have all of these long-term responsibilities.

Like I said, these are unintended consequences. You thought you were building flexibility to move suppliers, but if you start imposing standards then it creates a different picture.

ULF JONSSON: Ethics is an important aspect. What if you are trying to have a global ethics policy implemented in various countries and it does not work? I have known companies that have fired all their employees in one country because they knew they were not able to comply with their group standards, and then they hired them back as agents. So, there is always a creative solution somewhere around the corner!

GEOFF TAYLOR: The ethics question is fantastically complex. You can be in a business where all your competitors are doing something one way, and you decide you do not want to do it that way. But then you realise that you are losing market share. That poses an ethics question about your existing employees. Do you let the company go bust, and fire all of your existing employees just on a question of ethics, or do you join the game, and try and change the game internally over time and maybe compromise your standards in the short term but try to influence the outcome? Perhaps that would be best. Although it might compromise your ethical standards on day one, in the longer term you might have a better effect on the whole industry that you are in, and that could be a higher goal to attain.

ULF JONSSON: Trying to explain that to the investors is going to be tricky.

MARIE-GEMMA DEQUAE: Before going on to insurance topics, is there a risk in your countries that is keeping you awake at nights that we haven't yet discussed? Are environmental issues a problem now we have the Directive?

GÜNTER SCHLICHT: They are a problem because there is a new legislation so the existing environmental questions are being put into a new frame. It is a general liability which touches companies of any kind and size. We have to deal with the question of where this new liability is placing companies' exposure, and how this exposure is covered by the insurance companies. I think we have partial answers from different markets. The German insurers association is coming up with a model cover that is about to be published and will be presented to us. We already know some basic points but we don't know the wording yet. This will be the basis for discussion in our country and then we will see what the market does.

KADIDJA SINZ: The most important thing and the good news is that the market is reacting, is trying to find a solution, and it is for you to decide if this is the right solution. As a company, we are quicker to change than some others, but there is some uncertainty about the interpretation of the Directive and how it is going to be rolled out in every country.

I would say positively that the insurance industry will be able to respond. There is a willingness and a desire to be offering the right solutions.

FLORIAN MUELLER: In the US; there is a much bigger market for environmental cover due to the legal environment.

MARIE-GEMMA DEQUAE: The difference between Europe and the US is that in the US everything is excluded from the CGL policies, while in Europe there is still some cover in general liability policies.

FLORIAN MUELLER: In the UK there is already an environmental liability insurance market and has been for some years. My impression is that in other countries there is no market.

KADIDJA SINZ: There were pools initially. That was one of the answers, and now you have more answers from various players. The concept of damage to the ecosystem and the way it is going to be interpreted is a very important question. You can use some of the experience you have seen in other areas of the world, but not all of it because the way it has been done at European level is quite different to the way it was done in the US, and countries like China are another story. Do you agree with my assessment that the insurance industry is really trying hard to give you some positive answers?

GÜNTER SCHLICHT: The very fact that they are offering this is positive, of course. That is no judgement on the quality of the cover, but the very fact that there are propositions that they are offering is definitely positive.

KADIDJA SINZ: Once we have the first interpretation of 'damage to the ecosystem', we will be able to fine-tune and adapt.

FRANCK BARON: If you look at an average top risk map for a company, I would say that a very high portion of the risks are not covered or are not coverable by insurance. So is insurance still part of the toolbox of a risk manager, when you consider that of your top ten risks, only three or less of them are, in some way, linked to insurance?

GÜNTER SCHLICHT: The Geneva Association is working on a project that explores the borderline between insurable and uninsurable risks. What they are trying to do in a somewhat systematic way is see where and why the borderlines are drawn between insurable and uninsurable risks. They are trying to find out whether the limits could be different in the future, and on what criteria. They presented at our last conference and it is an ongoing project.

Ethics is an important aspect

ULF JONSSON

MICHEL YARHI: As a bank, we are subject to Basel II's requirements. What does Basel II require? That all banks have to master their risk - mainly operational risk – and have to put in front of that risk a certain amount of money to be sure that we can fund the risk that we might suffer because banks have to continue to work, or who knows what could occur.

So we have to put in place risk management activity, and, for the remaining risk we can insure ourselves like any other kind of company. The insurance can be considered as a mitigation for the amount of asset that has to be put in front of the risk but only if insurance complies with the rules of Basel. The rule of Basel is almost to set up a first-demand warranty, like guarantees provided by banks when there is an event and we claim the money and have it the day after.

Today, except for very specific kinds of insurance, fire insurance, for example, we are not sure that insurance can work very quickly and fully to reimburse the loss we suffer. For that reason, in answer to Franck, we are acting as if we were not insured. Of course, we buy insurance, but we consider that insurance we are buying as a 'gift'. We have to have the money that we need to fund our risk, and if, perchance, insurance works, it is a gift. It is a way not to spend the money that we have put in front of a risk.

Basel has been set up by bankers. Bankers understand how first-demand warranties work. Insurers do not. They have exclusions, there are clauses that can be interpreted in one way or another, there are deductibles. We tried to build a bridge between what Basel required and what the traditional market can offer, but it was very difficult.

Will insurance have a part to play as a financial instrument?

KADIDJA SINZ

KADIDJA SINZ: In the specific Basel II discussions, since insurance is mutualisation and is based on the indemnification principle, a guarantee on a first-demand basis was a little difficult to follow, as it has nothing to do with indemnification. In France, we are moving a step forward by giving at least some certainty over a two-year basis.

Coming back to Franck's question, which is: how is insurance reacting to these new exposures? I think we have seen that insurance companies have identified many more risks than before. Our job is to look at the risks that corporations will be working on mitigating by bringing in some capital instruments. Will insurance have a part to play as a financial instrument? Are we going to be the most cost effective? We are working very hard to identify where our model works the best and performs the most cost-effectively for you by internally focusing ourselves on capital allocation for your future risk, for example with natural catastrophes. And we are looking at the areas where we can create new products, working again on the mutualisation and indemnification principles, which will also enable us to manage better the systemic aspects because that is where we have a challenge.

The systemic aspect we can mitigate partially through our own capital allocation, and I believe most insurers are working very hard on this. And then there is specific product innovation to start giving you enhancements.

Yes, insurance companies are very much aware of the need to innovate. We are also aware that in the future we will be competing with other financial instruments, and we need to be prepared to give you the most cost-effective and comprehensive response.

ANTONIO FERNANDES: In that model of innovation, where do you think the insurance industry will go in offering us solutions in respect of new products? Will insurers move into other kinds of business areas or business risk and what kind of solutions will there be?

KADIDJA SINZ: There are definitely two areas which are growing. One is enhancing the offer in exposures we already know but which are getting more complex, for example business interruption, the errors and omissions aspects of liability cover. The risks already exist but they are taking on a new momentum, and, therefore, we need to fine-tune and enhance. Then you have the ones which we have been debating which we have problems finding solutions for, like reputation, volatility of supply prices, etc. We have difficulty in giving you answers there, so we try to frame them so that we can use our tools. We are also very dependent on a lot of the analysis you do and the way you describe the more specific needs. For example, in the case of recovering reputation, we would need to be able to find out how much it costs you, and just getting that answer is very difficult.

GEOFF TAYLOR: There often are things like reputation in the top ten risks, and they fall into areas which are very difficult to quantify, so that makes it very tough for you. Also, they are such huge risks for major companies that perhaps there is no capacity anyway, and what there is would always be subject to provisions.

Core risks – things like product development, product innovation, market share - should never be insured in my view. First, you do not want insurers and loss adjusters 'getting in the way' if something does go wrong. Second, these risks are hard to quantify and, really, if you cannot manage them, you do not deserve to be in business. We should not expect insurers to step up on some of those issues, because, frankly, they do not have the capital, and neither do we, to handle those risks in certain cases.

KADIDJA SINZ: We will probably have most innovation on the liability side because I think there are new aspects of liability and its impacts which are quantifiable, and we are looking very closely at the social evolution which increases the cost of certain liabilities.

GEOFF TAYLOR: Insurance is about having a lot of similar risks. You can put them together and create a portfolio. When you have lots of very specific risks that do not go together, they are not really insurable. We, each, in our companies have specific risks which usually appear on that top ten list.

MICHEL YARHI: Specific risks can be insurable - but at a price. At first, it is at a price that nobody can afford. Insurers do not want to lose money, they have to ask for a premium adapted to the risk, and people are not ready to pay for that.

FLORIAN MUELLER: Coming back to Franck's question, being a risk manager, when you look at your major risks and you find that insurers are covering one or two of your top ten, the question is to what extent insurers will be part of the equation. From a marketing point of view, I would like to say we could cover all your risks, but realistically it comes back to Geoff's point that we cannot provide cover for the real entrepreneurial risks - reputation, market share, innovation, product know-how, distribution channels. We are not prepared to do it because it does not make sense.

But we can offer something for the insurable risks. To what extent are you using insurance for these? Is it attractive? How much added value can we bring in things like engineering and mitigating risks, not just being a pure capacity provider, but more evolving to a solution provider?

MICHEL YARHI: For us, as risk managers, the most difficult thing is to make top management understand that if there is a risk, the first step is not to buy insurance. The first thing is to study the risk to try to mitigate it, and, after that, maybe we should buy insurance.

FRANCK BARON: I would challenge you on that, Michel. I would say that the very first thing you have to do in a company if you take a risk is to get a good return. Going back to my question for the insurance industry, I was not referring to covering our core business risks. We've spent some time discussing supply chain complexity. When you look at the way the insurance industry is structuring business continuity coverage, the way it is managing losses in these kinds of situations, it doesn't really reflect the very recent development of the supply chain worldwide.

I had a conversation very recently with insurers regarding business interruption cover relating to suppliers abroad. They said that we had to provide a list of all of our suppliers, so we did that. It was a huge number of companies, ranging from the biggest to someone in India providing patchouli. I have no idea what they are going to do with this. I think that here there is still room for innovation, room for adaptation in the business.

KADIDJA SINZ: That's what I was talking about. There are things we do quite well, but we need to work on adapting our model to new challenges and changes to the business model, and what is important to companies such as just in time delivery of supplies.

MARIE-GEMMA DEQUAE: We need process-driven coverage.

GEOFF TAYLOR: One of the classic issues there is that instead of looking vertically at clients, you need to look horizontally as well. Taking Franck's example, if you have one guy in India supplying patchouli, if you look at that you would say it was without risk. Then you find that you have a lot of clients on your books that are all getting patchouli from this one small guy in India, and then you have multiple hits on your capital for something that you did not perceive as a risk when looking at individual clients. It means getting sophisticated with data.

KADIDJA SINZ: Exactly. The work we have done on natural catastrophe mapping has shown a lot of these types of dependencies, and the whole analysis of interdependencies is helping us improve our coverage. That also means that we cannot purely be capacity providers.

FLORIAN MUELLER: Also it is important from the point of reinsurance, for example, that we manage our risk exposures globally, and know what our exposure is at any time and in any location. We like to work with companies who give us that information. We want to benefit from the competitive conditions, but also work in a proactive manner, and that also helps us get better reinsurance terms.

KADIDJA SINZ: But I take your point, Franck. It is important that when we ask for information we know it is information which we are really going to use and that it is meaningful because sometimes you probably get questions that you feel are not 100% relevant. We are working at being very focused in our questions, to avoid those which are just 'nice to have' and to keep those which are crucial.

FRANCK BARON: I am still pretty disappointed about the inability or difficulty that the insurance community has in integrating the quality of the risk management process of a company into your decision-making process. There appears to be no real sound robust process to assess the quality of the risk management process in our companies.

GÜNTER SCHLICHT: There is also a certain time-lag in following the risk evolution and organisational structure within companies between our demand for solutions and the provision of solutions. I think that is part of the problem.

GEOFF TAYLOR: I think what Franck is saying is that there is not really recognition in pricing of the quality of risk management. There is a slight element here that insurance is a technical thing, but sometimes it can be very like a commodity, and you sell capacity at a price. Sometimes to be competitive you want to use your capacity and you need to drop your price because there are other people out there with capacity as well, and if you do not sell it when you have reinsurance to pay for, then it all gets very complicated.
So, there is an element that technically you are looking at the quality of risk management, you are looking at the exposures, but because there is also this commodity element, it drives some different behaviours.

MICHEL YARHI: To answer Franck about the quality of risk management, I am not an insurer but I will try to give you the answer of one. How can you appreciate the quality of the risk management policy? You need the ratings approach. Who can rate the quality of the risk management activity in a company? It is very difficult although it will be easier for physical risks.
But with many activities, for example banks, physical risks are almost insignificant. So assessing the quality of physical risk management can work, but for intangible risks, I think it would be more difficult. And more and more, even in industrial companies, intangible risks are the most important risks today.

KADIDJA SINZ: I would say first of all that we do take risk management approaches into account and perhaps you need to see more feedback on that. As regards liability risks, people ask: 'If we put in place certain governance measures in a certain way, what impact will that have on our rating and on our analysis?' and we are working to improve our response. I agree that we need to give you more information on where we take good risk management into account and where we have difficulties.

MARIE-GEMMA DEQUAE: Perhaps we could move on to contract certainty and transparency. I think these issues have been solved in certain countries such as the UK.

GEOFF TAYLOR: They have reached a certain level where the FSA is satisfied. Whether that has completely solved them I do not know because obviously there are still some complexities. But on the whole, we are doing a much better job.

MARIE-GEMMA DEQUAE: Does that mean that you have a contract within 30 days of inception?

There is also a certain time-lag in following the risk evolution

GÜNTER SCHLICHT

GEOFF TAYLOR: That is a very good question, but I have not got the faintest idea because we have a global programme, based in the US. But with my AIRMIC hat on, I can say: yes, our members are getting the level of contract certainty they request.

GÜNTER SCHLICHT: In the UK it was an FSA activity, and the FSA pushed the subject into the market, which had to then act. I wonder whether it is considered a market problem in other areas.

In Germany, we have a situation where you would not have contract certainty in many circumstances, but I would hesitate to say that it has been considered to be a serious market problem or a sign of inefficiency of the market with severe consequences.

GEOFF TAYLOR: My understanding is not totally clear, but often in European countries you have a tacit renewal anyway which means that you are carrying on with the same contract you had before if nothing different is agreed. It is what you had last year.

MARIE-GEMMA DEQUAE: That does not apply to big global contracts. Certainly in Belgium the big players are pushing to have the contract issued earlier, with 'earlier' meaning three, four or five months after inception. We do receive a very extensive cover note before the inception date. The problem is that, not in property but in the liability environment, with our businesses changing our risks are also changing so we need new extensions and coverage, and these clauses have to be structured in a way that both parties agree. That takes some time to do.

TATIANA SHEMYAKINA: In Russia we have a different situation, particularly as regards transparency. We have a local insurance industry in Russia which is growing in the domestic market but it is likely to face increasing competition for business from international companies and brokers. International growth of the local reinsurance industry depends on a broader acceptance of rating agency financial ratings, stronger capital and increased confidence in the Russian market.

Among factors that positively affect the prospects for insurance market in Russia are investment in industry and infrastructure. Supervision is improving transparency but must demonstrate that it is fully applied and effective. The lack of international financial accounting standards does not allow transparency and could be considered as a negative. Lack of financial ratings also works against the market. Companies' capital levels are too low by international standards. There is a lack of experience and expertise in the market and the general level of insurance education needs to improve.

There needs to be a major improvement in the capital base of the market as a whole and even stronger regulation. There are a number of steps to take that would improve transparency like far more widespread use of internationally accepted accounting standards and the widespread acceptance of agency financial strength rating. There is also the anticipation that strengthening regulation will cause a reduction in the number of insurance companies in the market and may drive consolidation.

Supervision is improving transparency but must demonstrate that it is fully applied and effective.

TATIANA SHEMYAKINA

FLORIAN MUELLER: In Switzerland, we have a new law, the Revised Insurance Contract Act, which came into effect as of 1 January 2006, with provisions relating to the contract penalty enforced from 1 January 2007. Now, before the inception date of the policy, we need to provide the client with all the wording, the price, everything. If you fail to do that the client can withdraw from the contract.

FRANCK BARON: It is easy for us to blame the insurance industry but, in all fairness, it starts with the risk managers. If you want to start your annual process at an earlier stage, and you are clear about what you want and what you do not want, and aren't still arguing about clauses, you are going to be successful in achieving contract certainty. It starts with us.

KADIDJA SINZ: I would share your view that it is a collective effort because it often happens that there are different layers of cover or there is co-insurance.

MICHEL YARHI: I think that the main problem is that we consider insurance like a drug. For example, if you ask for credit from a bank, the bank will give you credit when both parties agree upon the conditions and the quality of the contract. You can spend a lot of time discussing the contract, and as long as there is no agreement, there is no credit. It is the same thing when you want to buy a new insurance. You spend a lot of time discussing it with insurers and, at the end of the day, when you are agreed about the conditions, you have a policy and you pay the premium.

The problem is when you renew insurance. That is the reason I said it was like a drug. You want the insurance's inception date to begin when the previous one ends. So, if you are not ready to take the risk of not being insured you are obliged to shorten the discussion, you are obliged to accept the insurer's conditions. That means that you discuss until the last day, and then you have three months or six months, or whatever, to get it in writing.

MARIE-GEMMA DEQUAE: I think for property risks it is feasible to have your contract at the inception date. With liability, cover notes are getting longer and longer, sometimes seven pages. Everything that has been discussed is mentioned, including the exclusions.

GEOFF TAYLOR: Another thing to consider, in terms of innovation, is that we are hung up on this annual cycle. Why is that? Why do we not have an evergreen policy with some sort of annual costing decision? Then you are not negotiating wordings, or perhaps you only negotiate them as and when changes occur in your business.

MARIE-GEMMA DEQUAE: I cannot agree with that. I am on a three-year programme but the wordings are renegotiated every time we make an acquisition or another change in the business.

GEOFF TAYLOR: You have to renegotiate all the time because you are in an ever-changing business, but perhaps if you were in a more static business an evergreen policy would make more sense.

KADIDJA SINZ: The European Commission is not very fond of those long-term contracts as it considers them anti-competitive.

FLORIAN MUELLER: Ultimately, regulation is driving market practice to an extent where we will not meet the clients' needs any more. It should be a client decision, whether you want to buy insurance for one or three years.

MARIE-GEMMA DEQUAE: There is also insurance regulation in each country, and that may have limits for the duration of the contract.