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RISK INNOVATION

SHOWCASING RISK MANAGEMENT
MATURITY AROUND EUROPE

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ITALY

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RISKS

Opening new markets is the key to recovery

Companies that survive and even thrive through a prolonged downturn are those that know how to innovate to accumulate

Last month, Italy was hit by another round of bad news concerning its economy – the landscape has failed to improve despite two years of austerity measures.

The news came from the country's National Institute for Statistics (Istat) and its prognosis was one of doom and gloom; GDP was expected to contract by 1.8% in 2013 compared with a previous forecast of 1.7%.

The prognosis followed disappointing news in August, when the country experienced a steep drop in industrial production.

The situation was not helped by continual instability surrounding a fragile left-right coalition, or an unemployment rate of 12.5% of the population, the highest since 1977. All these elements do little for domestic confidence even if Istat estimates for 2014 hints at a slow recovery.

Indeed, the projection points towards further economic challenges, which was why it was no surprise that financial risks topped the agenda at a risk managers' roundtable held at the ANRA conference in Milan last month.

The event brought together Italian risk managers from a broad range of sectors – technology, finance, aerospace production – to discuss their challenges and share examples of best practice. While the discussion centred on economic hurdles, it was only one of many risks highlighted by the table; compliance, supply chain, and cyber risks also featured highly. (goo.gl/4LSStX to full report).

Economic challenges

But whatever the risk, the underlying message was that sound risk management and proactive innovation were the best approaches to allaying any potential threats. This was indeed the advice from the table for how best to respond to economic challenges – an area that remains the top risk for Italian businesses in general, according to Fabrizio Sechi, risk manager at Italian telecommunication firm Fastweb.

"One of the most significant risks that we face is changes to the economic environment. This affects market conditions, placing pressure on prices, which can result in price wars in certain markets. Additionally, it can sometimes have a knock-on effect on our customers' ability to pay on time."

For financial institutions, the fallout from such a crisis is more immediate. "Banks have had a very big credit crunch and the impact was a reduction in the money available for lending activities in favour of clients," says Gianpaolo Corbella, insurance group manager at Italian multinational bank UniCredit.

"Fortunately, our group is strong in Eastern Europe compared with our operations in Italy and Germany. For example, in Poland, Romania, Bulgaria and Turkey market conditions are better, and in these markets we are seeing some growth in our banking activities compared with the domestic market. This helps to offset the slowdown that we are experiencing in Western Europe."

Corbella adds that banks have had to "manage changes" experienced in Western Europe: "What we are seeing is that a lot of customers in this part of Europe are more dependent on home banking, which is becoming more and more popular.

"As a result, banks are losing physical contact with the clients and therefore they have fewer opportunities to offer services that would be of benefit to them and their business. Banks have had to react to this and in some cases they have closed down smaller branches and ended agreements with some suppliers."

The production sector is also feeling the brunt of the downturn, says Gabriele Palandri, group insurable risk manager of Finmeccanica, Italy's leading aerospace, defence and security firm. "Recent market research tells us that Italy's production sector has been more affected by the economic downturn compared with other sectors."

"But this does not only concern SMEs, which are more exposed to fluctuations in the economy," he adds. "The downturn is also having an impact on large companies and consequently on

IN NUMBERS

0.9%
Annual inflation

$1,954bn
GDP

-0.7%
Real GDP growth (year-on-year)

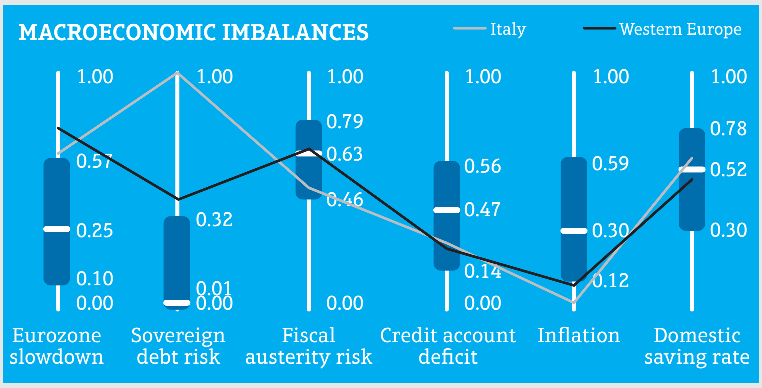
$32.0
GDP per capita, current $ (thousands)

-1.5%
GDP per capita growth (annual)

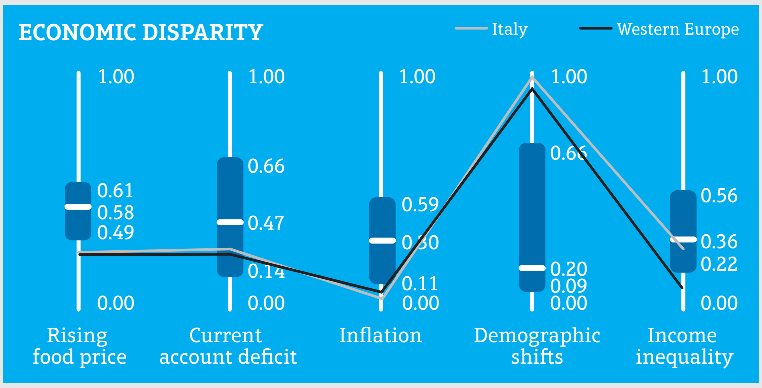
127.8%
General government debt (GDP)

66.5
Country credit rating, 0-100 (best)

-2.8%
Current account balance, three-year average GDP)



Italy is the largest economy of the eurozone periphery, so developments there pose significant upside and downside risks to other periphery nations, as well as the eurozone at large. On the positive side, the government's introduction of policies to promote growth has been effective in quelling the economic unwinding. And Italy's export sector has started to recover from its slump and is forecasted to be a major contributor to growth over the short to medium term. But Italy's risk outlook is hampered by structural challenges, in particular its latent political instability and a sovereign debt-to-GDP ratio that is higher than the Western European average, as well as the drag on economic growth stemming from fiscal austerity measures.



Along with its peers in the developed world, Italy is exposed to some key development and disparity risks that threaten to taint its long-run prospects. An ageing population coupled with low birth rates make state pension and other social security promises at current levels more difficult to maintain in the medium to long run. Italy has historically witnessed large emigration of both skilled and unskilled labour, which exacerbates this demographic trend. Finally, as in other advanced economies, Italy's income inequality – as evidenced in the gap between low/middle and high incomes – has grown in recent decades and is at a higher level than its Western European peers.

NOTE The risk bars indicate the world distribution of the particular risk, from the lowest-scoring country to the highest. The lower the score, the lower the risk or exposure to the particular indicator (a lower score is always positive).

Source: Zurich Risk Room

their subcontractors and suppliers, making supply chain processes more vulnerable."

But not all Italian businesses are suffering in this way. Multinationals with operations all over the world are, of course, in better financial health. Although this may not be immediately obvious if the overall GDP is anything to go by, says Alessandro De Felice, chief risk officer at Italian-based cable specialist Prysmian.

"The figure is misleading. The aggregated GDP is made up of two different, perhaps opposing measures – foreign demand and local demand. And this does not add up to represent the true reality. The reality is that there are a number of Italian companies that are not exposed to banks and which export their products to foreign markets. These companies are not suffering from the economic crisis. They are, in fact, growing and in profit."

Embracing change

The table's general consensus was that whatever the size of the business, whether it is a multinational co-operation or a domestic SME, those that survive through a prolonged recession are those that innovate, says Paolo Rubini, ANRA president and insurance manager at Telecom Italia.

"The reaction is always innovation – the economic crisis always brings innovation," says Rubini. "Italian businesses are trying to find a market and this is how some companies that are deemed to be dead are still surviving – they have been able to find a market and this is, of course, down to innovation.

"Businesses have to embrace change. As far as the telecommunications industry is concerned, the solution is to boost traffic by selling new services such as cloud computing. This is a way to find a new market in challenging times."

Palandri agrees, stating that over the past four to five years, a number of SMEs have turned to innovation, with a good percentage of their returns arising out of new and innovative solutions or products.

"Innovation is a characteristic of Italian businesses," he says. "Usually big companies invest considerable amounts of money in research and development. And during challenging times they are now focusing their attention on optimising R&D within the production process. Innovation is necessary for surviving."

Italy's economic situation is not the only threat that keeps Italian risk managers awake at night. Regulation and supply chain risks were among the topics also discussed, and the full report can be read on the *StrategicRISK* website (goo.gl/4LSStX). **SR**

INNOVATION IN ACTION

Re-educating the educators

The shifting nature of risk exposures from the purely material to the value of business reputation and customer satisfaction requires a rethink on management training

The Italian risk landscape is changing fast and Italian risk managers need to adapt just as quickly, according to Paolo Rubini, President of ANRA, the association representing Italian Risk & Insurance Managers.

"The new issues are not so much 'new risks', but rather the 'risks of innovation'," he says.

First and foremost is the transformation in Italian business assets. "What is changing is the nature of our assets," says Rubini.

He cites the shift from the primacy of mainly material assets – such as property – to the mainly 'intangible' assets – such as customer goodwill and business reputation.

Globalisation has also played a role, shifting the risk balance from owned assets and internal processes to the risks presented by reliance on external assets and outsourced processes, often in countries on the other side of the world.

"The nature of the exposures, and of the threats [we face] is changing accordingly," he says. "From damage to properties and hardware to damages to data, software and processes; from controllable risks to those risks apparently outside the control of the company," including contingent business interruption, political risk, computer hacking, the impact of the 2008 financial crash, the credit crunch – and the decisions governments and financial authorities have taken in response.

There has also been a shift "from first-party losses to third-party losses, because of outsourcing or, vice versa, insourcing," he says.

Control and mitigation

Recent debate has focused on whether or not it is possible to plan for many of these risks – and certainly many are currently beyond insurance. But Rubini believes that some control and mitigation is possible. "It is certainly possible to predict [these risks]," he says. "You can then model or embed the consequences of some of them on the relevant components of the strategic plans of a company. It is therefore also possible to define for such risk a level of risk appetite and retention.

"The problem would be to find capacity on the insurance market. But in some areas things are moving, innovation is stimulating the insurance industry."

Although some European risk managers bemoan a lack of imagination shown by insurers, Rubini is adamant that they are improving their products. For example, he thinks that insurers' response to cyber risk has been encouraging. "They have combined first-party losses and third-party losses in a single insurance package, with non-discrimination between material and non-material damage, on a standalone basis or as an excess, or difference in limits/difference in conditions cover on the traditional property/casualty insurance policies," he says.

Updating risk management courses

In addition, he believes that insurance firms have also provided useful solutions for non-physical business interruption risk, as well as non-damage business interruption and supply-chain risk. When it comes to political risk insurance they have provided capacity for structured risk financing solutions together with export credit agencies and banks.

One of the big challenges for Italian risk managers is dealing with compliance issues in a globalised marketplace.

Several risks are now regulated by legal provisions, such as environmental risk, governance, health and safety – and privacy.

"These are all areas where loss prevention is treated by laws," says Rubini. "This helps the risk manager but also entails new risks of non-compliance in areas that usually fall into the direct responsibility of the risk manager.

"In some areas the structure of the insurance policies has to change, according to these laws: environmental liability insurance needs to include a strong first-party loss insurance to cover the clean-up costs required by the law."

But an ever-more complicated risk environment has one particular advantage for the risk manager: a greater importance and respect for their profession, and Rubini believes

> **One of the big challenges for Italian risk managers is dealing with compliance issues in a globalised marketplace**

that there are now great career opportunities for those with the skills and drive to succeed.

"The risk manager is becoming a strategic department," he says. "Many companies are moving this function from the responsibility of the chief financial officer up to the first line of management, reporting to the chief executive."

In response, Rubini believes educators need to step up and help provide the right people to meet the needs of Italian businesses. "ANRA is carefully following this trend," he says. "We are working with the big Italian universities, including Bocconi and Politecnico di Milano, as well as other educational bodies (Cineas, MIP in Trieste, IFAF business school).

"The traditional courses on insurable risk management, claims management, risk engineering, all need to be updated because of the innovation within the insurance industry, and further courses on enterprise risk management (ERM) and risk governance must be added. This will provide risk managers with the knowledge required to grow their roles."

And it isn't just the profession looking at new opportunities. Italian employers also stand to gain from the growing role of risk management. "Our companies will sooner or later enjoy some public recognition of the advantages brought by the implementation of an ERM process and by a broader, more innovative insurance programme," he says.

"The increased resilience of the companies will reduce the risk of default and therefore increase their rating and bring material reduction in the cost of capital."

More disciplined, more efficient, stronger risk management has much to offer the Italian economy. SR

IN BRIEF

The need for a culture shift

Italian politics is famous for its long-standing arguments, fragile coalitions – and more recently the scandal-prone presidency of Silvio Berlusconi. But although there are signs of stability emerging, the situation is still precarious. "Prime Minister Enrico Letta has recently won a short-term battle for political survival, winning a confidence vote after conservative leader Silvio Berlusconi abandoned his attempt to topple the coalition following divisions within his own party," says Trevor Slack, senior Europe analyst at risk analysis company Maplecroft. "However, the near demise of Letta's fragile administration after just five months in office is indicative of the inability of a self-interested political elite to address the medium-term economic, political and social challenges facing the country."

In addition, economic problems, including high unemployment and immigration from North Africa and warn-torn Syria, are having a significant social impact, something that is feeding into politics and causing a swing towards populist rebels.

"The recent parliamentary elections saw the anti-euro Five Star Movement winning 25% of the vote, reflecting a growing disenchantment of Italians with established political parties," says Slack. "There has also been growing support for right-wing populist parties such as the Northern League.

"In the medium term, Italy is faced with serious social, economic and political challenges … Much will depend on the ability of the Letta administration to push through much-needed economic reforms needed to reverse the current downward trend.

"As things stand, his tenure on power remains uncertain at best, as shown by the recent confidence vote," adds Slack.

"However, there are deeper long-term challenges that may require a fundamental cultural shift at all levels of Italian government and society."

Economy's deep flaws worry Brussels

Although the eurozone's problems have eased over the past year, from near-crisis point in 2010-11, there is growing concern in Brussels, Paris and Berlin at Italy's failure to address the deep flaws in the eurozone's third-largest economy.

"Not least public debt worth over €1.9trn or 120% of GDP," says Trevor Slack.

"Accounting for 16% of the eurozone economy – compared to Greece's 2% – a major default by Italy could be disastrous for the continent and beyond.

Some analysts argue that Italy still has some way to go to reform its labour market, and turn its struggling economy around. "Labour costs are 30% higher than in Spain, for example, which – unlike Italy – has had some success in introducing greater labour law flexibility," says Slack.

"Foreign direct investment is a quarter of the UK equivalent and a third of that for France and GDP is now 7% below 2007 levels.

"The manufacturing industry continues to struggle, and with youth unemployment over 40%, Italy is facing a flight of young talent.

"There are also serious demographic challenges, with an ageing population relying on a shrinking workforce."

EXPERT VIEW

Knowledge is strength

Saverio Longo, chief executive, Zurich Global Corporate in Italy

There are two major options that businesses should consider if they are to become or remain successful in tough economic conditions. A business should either develop new products or explore new territories in which to do business. Remaining domestic is not an option. What we are seeing is that small to medium-sized domestic enterprises in Italy are struggling and consumer confidence remains low.

But those that are successful have become stronger than they were before the onset of the financial crisis. Those businesses innovated and moved into new markets. There were clear examples of this from the roundtable, where companies experienced growth during the crisis and are now in a stronger position than they were before 2008. Other customers have reported decreases in their domestic turnover but significant rises in global turnover.

Of course, as more businesses move into international markets, compliance risks are intensified and falling short of any regulatory requirements could cost businesses several thousands if not more. But, as a global insurer, we have the strength and capability to follow our multinational customers, insuring both their assets and liabilities all over the world. Over the past five or six years we invested a lot of money and effort to launch our Zurich multinational insurance application (MIA), making us one of the first insurers to improve compliance support and services to global customers.

Rules on property, liability, marine, and transportation insurance differ from country to country and, for a business operating in several different locations, keeping track of the ever-changing regulatory requirements will become a challenge. Zurich MIA will help businesses clarify local insurance laws, premium taxes and insurance-related activities for a number of risks across the world.

One of the major emerging risks cited by Italian risk managers is an increase in cyber attacks. On the same topic, risk managers also point out that Zurich, as a leading insurer, is expected to provide a high level of security in around confidential data.

Supply chain is also a key threat for Italian businesses, particularly regarding so-called second-tier suppliers. These are often hidden, meaning that in many cases businesses are unaware who their second-tier suppliers are. There are major risks connected to this as high-profile events such as the tsunami in Japan and Superstorm Sandy in the US have shown us.

Indeed, outsourcing is an option frequently chosen by Italian businesses. But it is difficult to offer insurance solutions when the supply chain is not clearly mapped. We have effective solutions that we can adjust to meet the needs of a specific company, but this can only be done if we fully understand their risk exposure. By having regular conversations with our customers, we will be able put together an insurance package that fulfils their needs, helping to strengthen their assets by protecting them from any risks. **SR**

INNOVATION IN FOCUS

Bloodlines that define the nation

Italy has a business class built on nepotism, but keeping it in the family has historically been a boon for the economy and is increasing the appetite for risk management

RISK MANAGEMENT IS BECOMING more and more of a key aspect of Italian companies. But it's not just the well-resourced multinationals that are aware of what the profession has to offer – the country's small firms are also enthusiastically growing their risk capacity.

"More firms of all sizes are realising that risk management is a strategic aspect of their business," says Alessandro De Felice, chief risk officer at the multinational Italian energy and telecom cables company Prysmian Group.

"The real innovation I am seeing in Italy is in the perception of risk.

"We are now constantly seeing an increase in the attention paid to risk management and the risks faced by companies in general.

"We are not talking about 'new risks', rather an increase in risk culture and a perception that managing risk is a strategic issue with real advantages," he says.

This booming interest is not only being driven by the giant multinational concerns, a fact that reflects the composition of the Italian economy.

Although multinationals have been important to economic growth in Italy, they do not represent the bulk of the economy. In fact, Italy has a smaller number of global multinational corporations than most comparable economies, and the backbone of its economy consists of small and medium-sized firms – it probably has more of these enterprises than any other Western European state, except Spain.

Outsiders might be tempted to write off Italian SMEs as nepotistic and inefficient, but this is far from the truth. The unique strength of the Italian economy has, since the country's remarkable post-Second World War recovery, come from the dynamism of its SMEs, many of which remain family owned.

With the rise of globalisation these firms have shown themselves to be adept at using their small size and flexibility to innovate, invest – and export. Italy has developed a manufacturing sector focused on niche luxury exports – rather than cheap mass-production – which has proved capable of facing down competition from emerging economies with its higher quality products.

The rise of Italian risk management over recent years reflects this reality. "It is mainly the large companies doing the big enterprise risk management (ERM) projects," says De Felice.

In Italy, as in other Western nations, listed companies have legal obligations regarding risk. "Any large company has, over the past two years, implemented an ERM approach," says De Felice. But the situation with SMEs is different. "Typically, this is the area where risk management and risk perception has not been seen as such an important issue historically," he adds. However, a lack of resources is not considered a barrier.

"We are seeing an increased demand for a proper risk culture and requests for training from these firms. They are acting now and doing something to face the risks that may affect business continuity and profitability. Mainly they are concerned with credit risk, in particular export credit risk. Many Italian SMEs are facing the internal economic crisis by exporting, but this means they are exposed to credit risk and political issues."

They are doing this by looking to independent consultants rather than building up an internal risk function.

"We are seeing that risk management consultants are really increasing their business, and this reflects the fact that many small companies cannot afford to have a dedicated person in-house and so they are asking for an external consultant to provide these services," says De Felice. "It's a growing business."

'The real innovation I am seeing in Italy is in the perception of risk'

Another spur to the development of Italian risk culture at SMEs is that many banks and financial institutions are now beginning to link the credit ratings of companies to their risk management. "Banks are looking more closely at how risks are managed at a firm before they lend them money," says De Felice.

"This makes sense; if you are investing in a company you want to see that they are managing risk across their assets. But as financial services generally are changing their business models to look more closely at risk management, so businesses are changing in response."

Liquidity problems

Of course, these developments are not universal – and not all Italian SMEs are able to take advantage of risk management as a strategic tool.

"To talk of an average SME is misleading," says De Felice. "There are a large number of small to medium companies that are not too affected by the crisis, that are able to innovate, to export, and who are not in the hands of the banks. Many medium-sized Italian firms are family owned and as such they don't necessarily have a problem with liquidity.

"But, of course, on the opposite side there are those companies that are heavily in debt to the banks, not able to export, and dependent on internal demand and don't have the liquidity to innovate. They find it much harder."

But, outside the years of cheap credit, these firms have always found it harder. Italian SMEs are, as a rule, resourceful. Where they can – where they have the capacity – they adapt and modernise, and make their advantage work as hard as possible.

It was the family-owned firms that transformed the rubble of 1945 into an economic miracle, and it is Italian family-owned firms that are now leading their country clear of the debris of the 2008 crash. SR

INNOVATION IN FOCUS

ITALY ECONOMIC STATISTICS

All indicators based on % change on one year ago

GDP

Current (Q2)

-2.2%

(Euro area average -0.6% Q2)

Change on previous quarter

-1.3%

(Euro area average +1.1%)

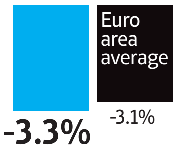
2013

-1.7%

(Euro area average -0.3%)

BUDGET BALANCE (EST)

% of GDP 2013



CONSUMER PRICES

+0.9%

(Sep)

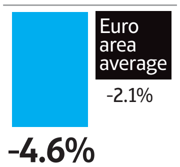
(Euro area average +1.1%, Sep)

2013

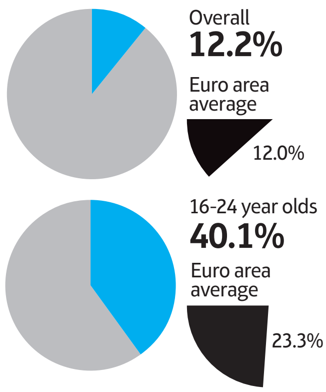
+1.5%

(Euro area average +1.5%)

INDUSTRIAL PRODUCTION



UNEMPLOYMENT RATE



CURRENT ACCOUNT BALANCE

Latest 12 months, $bn

+11.5

(Aug)

(Euro area average +247.7, Aug)

% of GDP 2013

+0.5%

(Euro area average +2.2%)

INTEREST RATES

10-year government bonds, latest

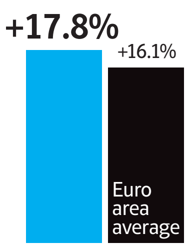
4.19%

(Euro area average 1.69%)

STOCK MARKET

Italy 30 October 2013

(% change in euros since 31 Dec 2012)



Source: *The Economist* and Eurostat

BROKER VIEW

Greater consolidation

Andrea Bono, central director of risk management, placement and specialties, Marsh Italy

The insurance market in Italy is intimately linked to the macroeconomic climate. Italian GDP has been falling in recent years, down 2.5% in 2012 and 1.8% in 2013. At the moment there is a small growth – 0.5% – projected for 2014, but we would not be surprised if it is flat. Also, unemployment is high at 12-13%.

Looking at the total insurance market, in 2012 the premium spend in Italy was €105bn. Of this, €70bn was life insurance and €35bn non-life insurance. Of the non-life cover, 50% was motor. Premiums have gone down across all these sectors in recent years owing to the difficult economy.

Despite or because of this, capacity is good and, generally, conditions are still softening. All the big international players are present in Italy, mainly in Milan, usually considered as the financial capital. In the domestic market there have been some interesting moves towards greater consolidation. Italy's biggest insurer Assicurazioni Generali, which last year appointed a new chief executive, Mario Greco, has recently merged several subsidiaries – Assitalia and Toro Assicurazioni – and the firm is going through a transformation.

This has had an impact on us as a broker; three channels have become one.

In addition, insurer Fondiaria-SAI has been taken over and merged with rival firm Unipol. In the past these carriers have not been particularly focused on corporate business, and we expect this to change and their appetite to increase.

As regards different sectors, property rates are soft and going down, despite the impact of last year's earthquakes in Emilia Romagna. We're finding that if you don't have particular nat cat exposure, rates are coming down. If you do have significant exposure, rates are remaining quite stable.

Liability rates are softening. Until a couple of years ago property dominated our portfolio, but now liability is becoming much more significant. Motor rates are softening – until recently they have been quite hard.

Financial and professional liability and directors' and officers' on commercial risk is softening, but there has been some hardening, mainly for the financial institutions, while the local marine has not been too affected by the Costa Concordia and remains stable.

The number of clients looking for credit risk cover is increasing as more firms seek protection.

The biggest change has come with professional indemnity (PI). Since 2013 PI cover has been compulsory for almost all professionals, such as engineers and lawyers. It will also soon be compulsory for medical professionals, probably by mid-2014. This is largely a new market with a lot of potential. **SR**