StrategicRISK

Risk and corporate governance intelligence

EUROPE EDITION

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NEWS & ANALYSIS » Corporate espionage » In-house lawyers' employment contracts » Australia Focus

VIEWPOINTS
[PROFILE] Aon Global Risk Consulting chairman Stephen Cross explains why data and analytics are crucial to determining effective risk strategies and outcomes

GOVERNANCE
[MONOPOLIES] China cracks down on business practices of major foreign-owned corporations with painful and expensive consequences for some businesses

SECTOR VIEW
[BIOTECHNOLOGY] Dealing with risks in a challenging environment where safety and security means everything

THEORY & PRACTICE
[M&A] Cass Business School researchers reveal why the secret of takeover success depends on staff integration

BORED ENGAGEMENT

Dealing with directors can be a frustrating experience – find out how risk professionals can ensure their undivided attention

News Feature
Is Bitcoin the future of financial transactions or a dangerous gimmick?

Risk Atlas
World's most risky nations identified and assessed on political instability

Risk Indicator
What the WEF warning on income disparity really means for future

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It's about time the board woke up and listened

FEW THINGS ARE MORE FRUSTRATING THAN ISSUING A LEGITIMATE warning nobody takes seriously or, worse, acts upon. Risk managers experience this problem more often than most professionals.

Getting the attention of the board is a concern for many international risk managers. Some are more successful than others as their businesses are more receptive to their concerns or operate pure enterprise risk management policies driven from the top. They are the fortunate ones. Others have to work in isolation and achieve true board engagement only when a problem arises – more often than not, one that this same risk manager has highlighted previously without eliciting a response.

A perception still persists within some organisations that a risk professional is a perpetual bearer of bad news. Boards don't want to be encumbered by operational difficulties – they want to languish in isolation to consider corporate strategies. That, at least, is the persistent view of a sizeable number – to the eternal frustration of the risk professional.

A perception still persists within some organisations that a risk professional is a perpetual bearer of bad news

Board engagement is the theme of this issue. On pp19-23, we look at the reasons why boards are sometimes aloof, and consider strategies risk managers and directors can deploy to operate more effectively together.

We also report on the rise of virtual currency Bitcoin (pp10-12). This complex trading platform that once was the domain of antisocial nerds is now going mainstream. But who truly understands the system and how it functions? More importantly, what are the implications for business?

Complexities of a different kind are explored in Sector View (pp30-33), which delves into the niche but expanding world of biotechnology. Key risks are explored against a backdrop of potential insurance options to be run in tandem with innovative mitigation strategies.

An expert with something to say about biotechnology, Bitcoin and almost any other risk discussed in this and most other issues of *StrategicRISK* is the subject of our Viewpoints interview (pp13-16). Stephen Cross, Aon Global Risk Consulting Chairman and chief executive of GRIP and Global GRIP Solutions, is a self-confessed "data junkie" whose extraordinary insights drive not only Aon's operational strategy but also that of thousands of other companies worldwide.

Our Governance section (pp34-35) reveals how Chinese legislators are coming down hard on the allegedly anti-competitive practices of foreign businesses. With more and more large corporations gaining traction in these markets, the penalties being handed out will make companies take notice. Not even the most myopic board can ignore that. **SR**

Mike Jones, EDITOR, STRATEGICRISK

→ **Email** mike.jones@strategic-risk.eu or follow me at twitter.com/StrategicRISK

Editor Mike Jones
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Cover image Shutterstock
Email: firstname.surname@nqsm.com

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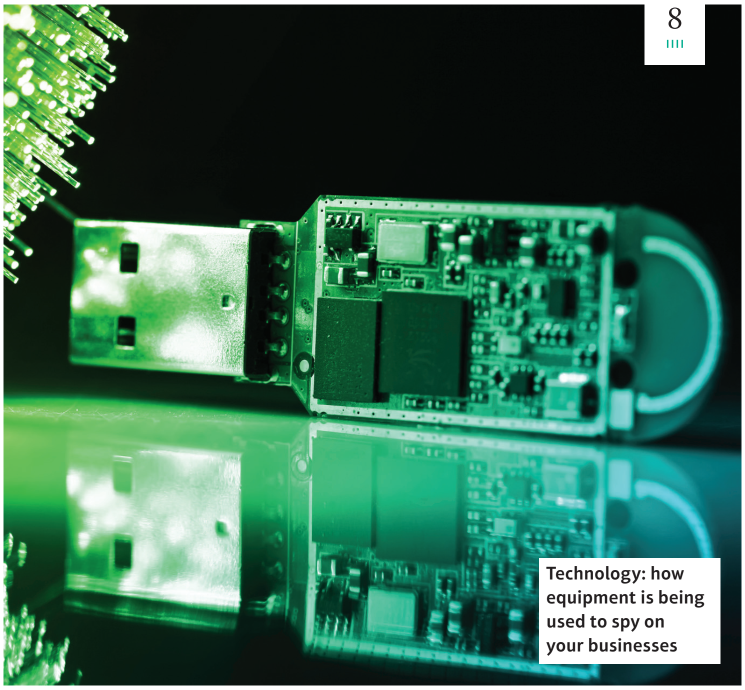

8

Technology: how equipment is being used to spy on your businesses

34

Chinese authorities have started a campaign against allegedly anti-competitive arrangements

NEWS & ANALYSIS

VIEWPOINTS

RISKS

SECTOR VIEW

GOVERNANCE

DOMICILE FOCUS

SR ASIA

THEORY & PRACTICE

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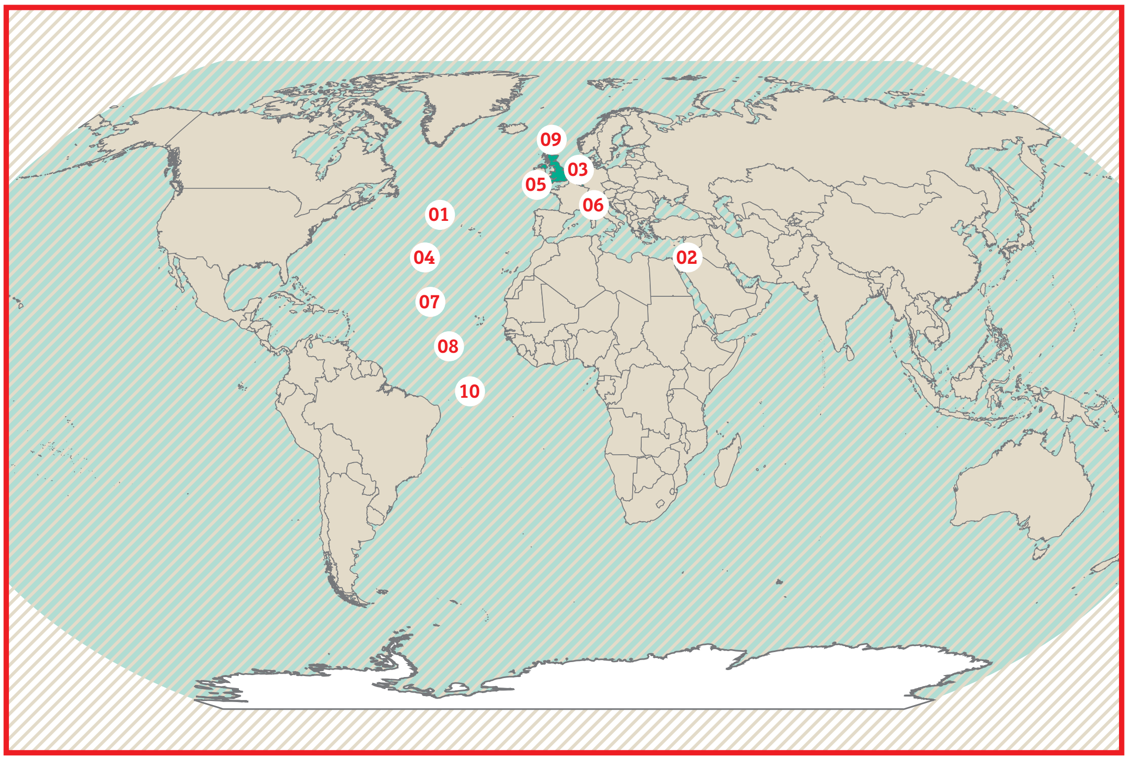
NEWS

TOP 10 ONLINE BUSINESS STORIES



01 ECONOMIC

Income disparity tops WEF Global Risks 2014

Income disparity is the most likely risk to cause serious global economic damage in the next decade, according to the World Economic Forum's *Global Risks 2014* report.

The report surveyed more than 700 international experts who assessed 31 global risks that have the potential to cause significant negative impact across entire countries and industries.

Although a chronic gap between the incomes of the richest and poorest citizens is the most likely threat to an economy, the key message is that global risks are interconnected and have systemic consequences.

web. *bit.ly/1bo8mL0*

02 POLITICAL

MENA countries fail to address fiscal imbalance

The risk of terrorism and political violence is spiralling out of control in the Middle East and North Africa (MENA) as countries are failing to address fiscal imbalances, according to Aon Risk Solutions.

Fifty-two per cent of recorded terrorist attacks in 2013 were located in the MENA region and represented an 11% increase on 2012's figures, according to Aon's 2014 Terrorism and Political Violence Map.

web. *bit.ly/1ewFBqg*

03 FINANCIAL

More than 50% of UK businesses are taking more risks

Signs of economic recovery have prompted businesses to take more risks than two years ago, according to QBE head of risk solutions Richard Thomas.

Speaking after the publication last month of the insurer's research, which revealed that 54% of the companies surveyed were taking more risks than 24 months ago, Thomas said businesses are feeling more bullish about taking risks and are doing so to gain competitive advantage.

Thomas told *StrategicRISK*: "The UK is coming out of the most serious financial crisis in 80 years, so the economy is having a big influence on businesses' risk-taking practices."

web. *bit.ly/1cswnv3*

04 CYBER

Employees need more IT training to fight cyber risks

Aon urged businesses to improve IT training so that employees are better able to respond to the increase in cyber risks.

Aon Risk Solutions global practice leader (cyber) Kevin Kalinich said despite companies worldwide having increased investment in cyber security, the value of that will be lost if employees are not fully trained.

web. *bit.ly/1oM05Uh*

05 RISK TOOLS

New tech tools used to build risk maps

Willis has been involved in projects using new tools to build effective risk maps.

Willis practice leader, integrated risk management, Tom Teixeira said: "I've been involved with a number of projects using the latest tools and technology – software environments and simulations – that create a map of the world and use all the information available to identify and map where facilities are. As a result of these, our clients can then take the latest risk mapping information and overlay it on their supply chains."

web. *bit.ly/NCm4iJ*

06 INSURANCE

XL makes key appointments

XL Group has confirmed that it is "very likely" to make further appointments to its international financial lines business following a series of new hires this year.

In January, the insurer made four key appointments in a bid to develop its international services for multinational organisations.

Simona Fungalli was hired to lead the insurer's professional indemnity business in Europe, Asia-Pacific and Latin America. She joined from Zurich, where she was chief underwriting officer, professional indemnity.

web. *bit.ly/1eNtIBO*

07 FINANCIAL

Risk spending expected to rise in 2014

Companies are planning to increase spending on risk management as a new investment phase draws nearer, according to international financial and investment consultant Smith & Williamson.

A survey by independent accounting and consulting network Nexia International, *Global Risk Management Survey*, revealed 48% of businesses plan to raise spending on risk management in 2014.

The rise in expected risk management spending is in a large part due to a post-financial crisis investment phase as firms look to expand and grow, said Nexia member firm Smith & Williamson partner and head of international services Stephen Drew.

web. *bit.ly/1ntVv9M*

08 INSURANCE

Insurers urged to switch tactics

Insurers must adopt a more consultative approach and become service-oriented to keep up with client expectations, says ACE Group European president Andrew Kendrick.

Kendrick believes the key risks facing businesses require alternative tactics to the traditional approach of product supply, which insurers have harboured up to the present day.

Kendrick was responding to the results from ACE's *Emerging Risk Barometer 2013*, which surveyed leaders in 650 companies in Europe, the Middle East and Africa (EMEA).

The results revealed a 'big four' that EMEA bosses believe are most likely to significantly financially damage their businesses in the next two years being: infrastructure and supply chain (45%), environmental risk (42%), cyber risk (40%) and directors' and officers' liability (40%).

web. *bit.ly/1er5bfS*

09 FRAUD

Insiders commit almost half of company frauds

Almost half of company frauds are perpetrated by employees, says research by KPMG. Its bi-annual fraud barometer also revealed that senior management are the biggest offenders.

Just under 40% of fraudulent cases were committed by management and a further 10% by employees.

KPMG tracked all 283 fraud prosecutions in UK Crown courts in 2013.

The barometer showed an increase in criminal prosecutions related to fraud, albeit with a lower average case value of €3.5m, compared with €7.37m in the past five years.

web. *bit.ly/1lCEuLw*

10 ENVIRONMENTAL

ACE raises environmental liability insurance capacity to $50m

ACE Global Markets announced that it will offer increased capacity of $50m (€36m), up from $30m, for global clients seeking environmental liability insurance coverage.

The insurer said it has raised capacity because "coverage provided by more traditional insurance policies is not sufficient for the exposures that companies face today".

Environmental risk manager, UK and Ireland, Emma Bartolo, said: "Environmental exposures and the liabilities they create for businesses have become increasingly onerous and they now affect many industries more frequently, and to a greater degree."

web. *bit.ly/1dEJSay*

ONLINE CONTENTS

Most read stories

Aon and Manchester United: Leading from the front
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AMRAE 2014: Q&A with Gilbert Canameras
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COMMUNITY UPDATE

Five key points of resilience are essential to keep companies out of trouble, according to an Airmic report produced with Cranfield School of Management.

Risk radar; resources and assets; relationships and networks; rapid response; and review and adapt are essential elements for businesses to have in place, as identified in the finalised version of the long-awaited *Roads to Resilience*.

The study is the follow-up to the widely acclaimed *Roads to Ruin*, published by Airmic in 2011, only this time looking in the opposite direction.

Spanish risk management association AGERS has appointed Juan Carlos López Porcel, ArcelorMittal Southern Europe director of risk and insurance, as its new president.

The association's board members voted unanimously for López Porcel in January. He replaces outgoing president Zarandona Michelangelo, who stepped down after leaving his position as risk manager.

López Porcel was previously the association's vice-president and sat on various committees and working groups.

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Criminal prosecutions for fraud have increased in the UK, according to KPMG

The poor get poorer

As the global economy begins to pull itself out of the five-year financial crisis, the gap between rich and poor shows no sign of narrowing

GROWTH AND STABILITY ARE TWO WORDS on the lips of financial and government leaders around the world, but a major risk threatens to halt the global economic recovery: the chronic gap between the incomes of the richest and the poorest.

While companies aim to encourage growth within their organisations by capitalising on the plentiful opportunities found in emerging markets such as Latin America, Africa and Asia-Pacific, native people in those regions are living below the poverty line, in many instances without support or aid.

Severe income disparity was ranked fourth in the top 10 global risks of highest concern in the World Economic Forum (WEF) 2014 survey of more than 700 global leaders. Further, for the third year running, the issue was rated the most likely to cause serious damage globally in the coming decade.

Before the launch of the WEF report, charity Oxfam released shocking figures revealing that almost half of the world's wealth is owned by only 1% of its entire population and that the richest 85 people on the planet own the same as the lowest 50% of the global population.

Income disparity is not a new or uncommon risk, but it is the alarming rate at which the gap continues to widen that is likely to cause organisations difficulties in the next 10 years.

Although income gaps between countries have narrowed, WEF chief economist Jennifer Blake said the gap within key emerging economies was a serious cause for concern. "The message from the Arab Spring and from countries such as Brazil and South Africa is that people are not going to stand for it any more," she said.

The risks related to income disparity are by no means confined to the developing markets. A key trend interlinked with the widening gap between high and low earners is the increasing levels of unemployment and underemployment in key economies, according to the WEF report.

The average unemployment rate for EU countries continued to rise in 2013. If this trend carries on, the societal and political unrest that has surfaced in emerging economies could begin to appear in established European economies.

At the end of 2013, the French government revealed unemployment levels had reached a 16-year high, while Spain's unemployment rate crept up in the last quarter of 2013 to 26.03% as the working population in the country shrank.

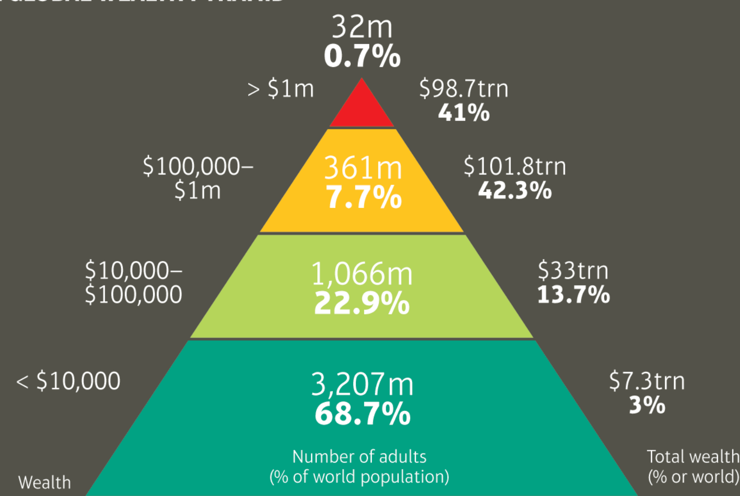
Swiss Re group chief risk officer David Cole believes the contribution of unemployed youths towards the overall figures is an issue that must be addressed. "As a result of the financial crisis and globalisation, the younger generation in the mature markets struggle with ever fewer job opportunities and the need to support an ageing population.

"Meanwhile, in the emerging markets, where there are more jobs to be had, the workforce does not yet possess the broad based skill-sets necessary to satisfy demand."

He continues: "It is vital that we sit down with young people now and begin planning solutions aimed at creating fit-for-purpose educational systems, functional job markets, efficient skills exchanges and the sustainable future we all depend on." SR

Income disparity

THE GLOBAL WEALTH PYRAMID



MAIN RISKS FROM INCOME DISPARITY

Political instability

Social tension

BIG NUMBERS

7 out of 10 people live in countries where economic inequality has increased in the last 30 years

WEALTH PATTERN IN EUROPE, ASIA-PACIFIC AND CHINA

	Europe	Asia-Pacific	China
> $1m	10,236 adults (000s)	5,266 adults (000s)	1,123 adults (000s)
$100,000 –$1m	143,275 adults (000s)	89,941 adults (000s)	23,733 adults (000s)
$10,000 –$100,000	156,880 adults (000s)	224,869 adults (000s)	390,146 adults (000s)
< $10,000	272,981 adults (000s)	786,495 adults (000s)	583,252 adults (000s)
All levels	583,373 adults (000s)	1,106,571 adults (000s)	998,254 adults (000s)

Income disparity:

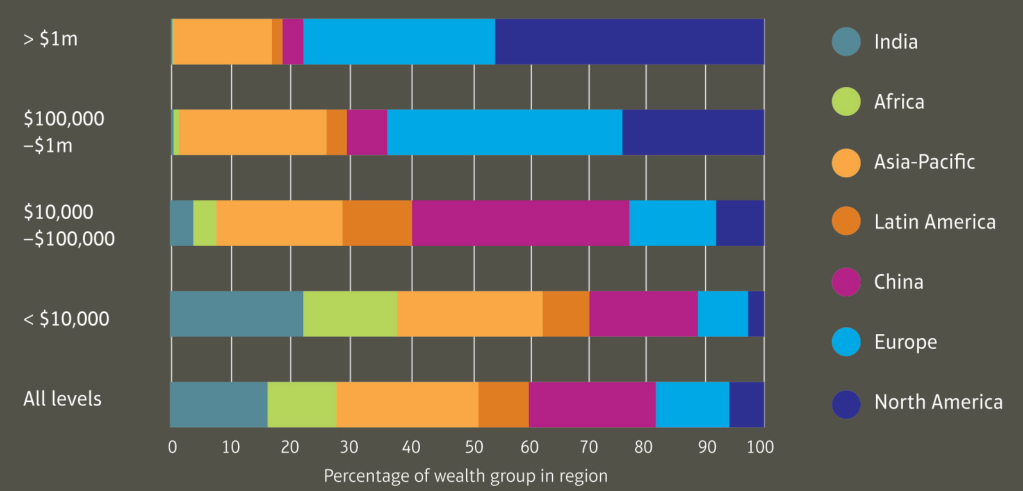
- has negative impacts on economic growth and poverty reduction
- can multiply social problems
- has potential for governments to work for the interests of the rich
- is morally questionable

Oxfam: Working for the Few 2014

“Inequality is ‘impacting social stability within countries and threatening security on a global scale’.

WEF: Outlook on the Global Agenda 2014

REGIONAL MEMBERSHIP OF GLOBAL WEALTH STRATA

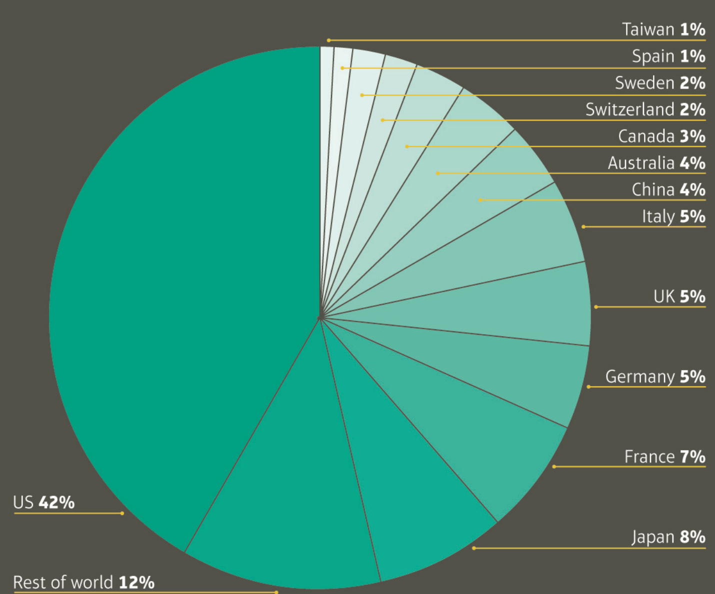


$18.5 trn Estimated to be held unrecorded and offshore

10% of the global population holds 86% of all the assets in the world

50% The projected increase in millionaires worldwide by 2018

DOLLAR MILLIONAIRES BY COUNTRY OF RESIDENCE



NUMBER OF MILLIONAIRES IN 2013 (000s)

Selected countries	
US	13,216
France	2,211
Germany	1,735
UK	1,529
South Korea	251
Brazil	221
Singapore	174
Indonesia	123
Hong Kong	103
Malaysia	38
Regions	
Africa	90
Asia-Pacific	5,266
China	1,123
Europe	10,236
India	182
Latin America	569
North America	14,213

Source: Crédit Suisse *Global Wealth Report 2013*, Oxfam *Working with the Few*

TOP FIVE

Fastest growing populations

1. Libya
Libya has the fastest-growing population on earth, with an average annual growth rate of 4.85%, according to the latest figures of the CIA World Factbook, which considers births, deaths and the balance of migrants entering and leaving.

2. Zimbabwe
Zimbabwe’s population increases by 4.38% on average every year.

3. South Sudan
South Sudan has an average annual population increase of 4.23%.

4. Qatar
The only country outside of Africa to make it to the top five, Qatar’s population increases by 4.19% on average each year.

5. Uganda
Uganda’s population average growth rate is 3.32% per year.

“SOUNDBITES”

‘There are a lot of issues around Bitcoin, so I’d be surprised if it were recognised as a currency’

Dill Dodwell, Deloitte

>> see **News feature, page 12**

‘We are pulling away into preventive and predictive space versus the backwards-looking reactive space’

Stephen Cross, Aon

>> see **Viewpoints, page 16**

‘Biotechnologies don’t tend to make products themselves, they make them in the lab, get them through animal tests and then go to specialist companies to get this stuff made for human trials’

Christopher Pryce, Marsh

>> see **Sector view, page 30**

The spying game


Shutterstock

Technology can speed up business operations, but it can also threaten companies as cyber dangers emerge

ACCUSATIONS THAT RUSSIA tried to spy on delegates at the G20 summit in Saint Petersburg last autumn using compromised USB sticks and mobile phone chargers have led to fears that simple hardware bought by companies could put their secrets at risk.

Russian president Vladimir Putin moved swiftly to denounce the allegations made by two Italian newspapers, but the idea of such technological vulnerability raises important questions for risk managers. How can you be sure equipment bought and used by your company and your employees is not being used against you to steal information or eavesdrop?

With corporate espionage on the rise, it seems companies and individuals can never be 100% certain of security and safety, and policies to prevent IT hacking may not cover this. There are also fears that products are having hacker 'backdoors' built into them during manufacture.

So what risk management procedures do organisations have in place to guard against threats from out-of-the-box equipment and machinery?

According to the Kroll *Global Fraud Report 2013/14*, there is a need for increased spending by risk managers on management and compliance processes. Efforts range from thoroughly investigating the supply chain when new equipment is delivered to implementing Bring Your Own Device policies for employees. Awareness should also be raised about the dangers of accepting sample technology offered by third parties.

Kroll Advisory Solutions Eurasia chairman Tommy Helsby says: "Perpetrators of fraud are often thought of as faceless hackers in a distant land, but our experience shows that to be the exception rather than the rule. The greatest vulnerability is among those who have already got past most of your defences by virtue of being an employee, partner or contractor.

"It is vital that, as well as investing in technology, businesses mitigate the insider threat by focusing on areas such as staff screening and due diligence on partners, clients and vendors."

Spyware in kitchen equipment

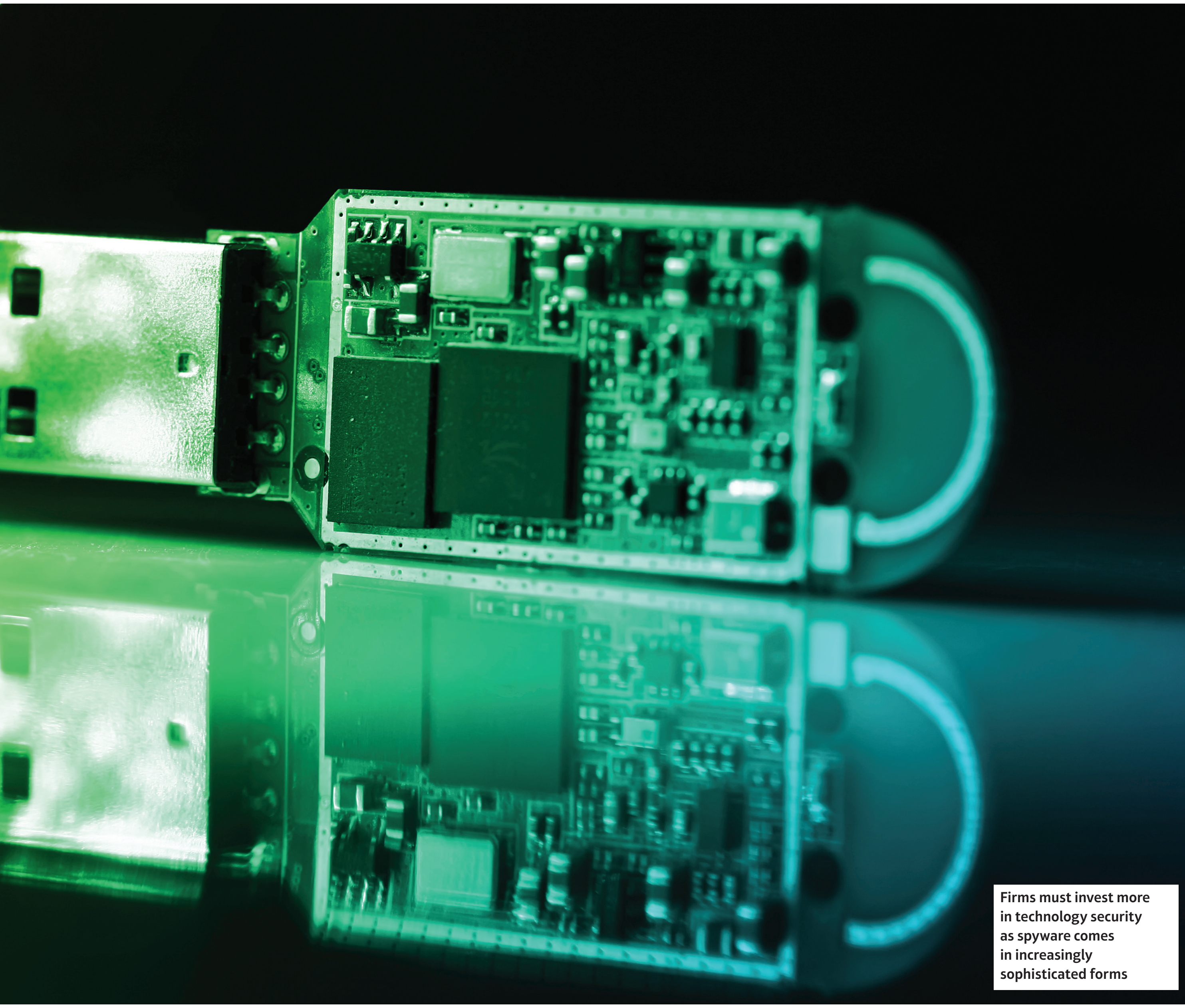
Information Risk Management technical director James Wootton highlights potential threats from everyday electrical items, such as the kettles in a company's canteen. A recent Russian investigation claimed that Chinese-made kettles could contain hidden technology capable of connecting to a local wi-fi signal and transmitting sensitive data to a third party – drawing on the appliance's power source to operate.

Wootton says: "The prevalence of inexpensive computing platforms and, at state level, the ability to create small, bespoke devices, would suggest that embedded attacks are on the increase.

"The device is energised when the kettle or toaster is powered and it will seek out insecure wireless networks to communicate, performing attacks or reconnaissance, or waiting for further instruction.

"While, on the whole, secreting such devices within batches of consumer goods would seem reactively untargeted and opportunistic, it has also been suggested that such devices have been found embedded in mobile products."

He continues: "Companies must consider their supply line. An interested party will look for the weakest attack vector. This may be a supplier or partner organisation/company that has been infiltrated, and spyware secreted within control, administrative or production systems. The sophistication and availability of devices capable of being embedded will increase and bring with it an increase in this novel but threatening attack vector."



Firms must invest more in technology security as spyware comes in increasingly sophisticated forms

Corporate security specialist KCS Group's chief executive Stuart Poole-Robb says a major risk is not spyware embedded at source by manufacturers, but espionage technology being placed into products such as computers or phones during less secure stages of the supply chain – for example, when they are shipped to a distributor, transporter or reseller.

Supply chain weaknesses

Poole-Robb says: "The exploitation of supply chain vulnerabilities has become an emerging trend. It should be taken very seriously indeed, as the impact is far-reaching, costly and destructive."

"When people buy a new PC, they often expect that machine to be secure out of the box. The fact that malware is being inserted at such an early stage in the product lifecycle turns this on its head and means that no matter how discerning a user is online, their caution becomes irrelevant if that PC is already tainted."

He adds: "Everyday appliances are having GSM [Sim] cards installed in items such as three-way adaptors, TVs and telephones. We have even found a transmitting device in a lock on the office door of the chief executive of one of our clients.

"More recently, we discovered an electronic eavesdropping device under the desk of the chairman of the advisory board of a blue-chip German company, and in the executive washrooms of one of the world's leading insurance companies."

To offset these kinds of risks, says Markel International insurance underwriter Dominic Yau, it is crucial to choose the right insurance product.

"These products can include cover for the costs of rectifying damage caused by spyware to the internal systems at factories and manufacturing facilities," he says.

"It is imperative that policies come with rapid-response helplines to deal with these types of issues."

Other security analysts agree that concerns over embedded spyware in machinery and communications technologies – such as eavesdropping abilities in mobile phone batteries – are real and growing.

Kaspersky Lab senior security researcher David Emm insists that businesses cannot afford to be complacent.

"If your organisation has never suffered a targeted attack, it's easy to tell yourself that 'it won't happen to my business', or even to imagine that most of what is written about these kinds of threats is just hype," Emm says. "It's important for organisations to invest in security, and to increase awareness of these risks throughout the business." SR

Reuters

FLIP SIDE OF THE COIN

While the popularity of secretive virtual currency Bitcoin continues to soar, questions remain over its market volatility and the risks associated with its use

OVER THE PAST 12 MONTHS Bitcoin has made headlines globally with stories of crime, loss and unpredicted success. Now the virtual currency is starting to make an impression in the real business world.

Since its launch in 2009 by the pseudonymous creator(s) Satoshi Nakamoto, the value of a Bitcoin has swung, fuelled intrigue and created confusion.

In December 2013, the price of one Bitcoin was €890, which made it as valuable as an ounce (31g) of gold.

Bitcoin's secretive and decentralised nature has attracted users of the 'dark web' and Bitcoin became the common currency on the infamous and now defunct Silk Road website, where users traded illegal items anonymously. Furthermore, links to organised crime have plagued its short existence, prompting arrests on charges of money laundering and theft.

On the plus side, businesses are increasingly accepting Bitcoins as payment for services and goods and the world's venture capitalists are also backing it. So, do its advantages outweigh the disadvantages?

Bitcoin's market volatility and security issues are obvious risks. Significant swings in value mean firms must contend with the same fluctuations as those experienced by foreign currencies – only more extreme. Even though Bitcoin reached the price of an ounce of gold in December 2013, its value halved within weeks and then increased again.

Another issue is that once a transaction has been initiated, it is irreversible. Thus, if Bitcoins are stolen from a user's digital wallet (see overleaf) or sent to the incorrect address, it is extremely difficult to retrieve them as users can withhold identifying information from their account.

In terms of security, companies cannot insure against theft or loss of Bitcoins for various reasons, including the fact banks or other authorities do not recognise it as a currency. The high volume of Bitcoin thefts from individuals and organisations would discourage an insurer from covering the risk.

Former managing director of Deutsche Bank Guenter Droese dismisses the hype around Bitcoin and the notion that it could rival the euro, dollar or pound. "The reason why the value has increased is, more or less, that there are too many people with too much money and they don't know where to invest their money with proper interest rates or development of value," he says. "They are gambling. A lot of the people investing in Bitcoin are gamblers."

According to JLT specialty partner and Global CTM Practice head Peter Hacker, Bitcoin's potential success in rivalling traditional currencies will depend largely on its acceptance across central bank systems. Support from large economies will fuel necessary investment into Bitcoin's reputation while the emerging economies will dictate its growth.

"For Bitcoin to gain wide acceptance and be considered safe with less value fluctuation, people need to invest into the reputation of the system and address widespread current concerns, such as misuse, to protect consumers while finding a balance between regulation and anonymity."

Hacker believes that, with global regulations in place and value stability, insurers could collate necessary qualitative and quantitative data to underwrite and price information security (cyber) risks associated with Bitcoin.

Challenges in store

Alternative methods of Bitcoin storage to the digital wallet are now available. Convinced of Bitcoin's promising future, Elliptic Vault has become the first organisation to offer insured storage of Bitcoins, using a technique called "deep cold storage".

Elliptic Vault co-founder Tom Robinson says the complicated, unfamiliar nature of the cryptocurrency meant securing the backing of underwriters was tricky.

"It took a bit of time. We spoke to many underwriters and our challenge was explaining the concept and describing what the risks are and how we were going to mitigate them," he says.

"Once we were able to do that in a clear way, we were able to secure an insurer. The risks are loss, mistakes by us or theft. We had to make clear the extent to which we were going to secure the Bitcoins until the insurers would subsidise. Our coverage

denominates in pounds sterling, not in Bitcoins, because of its volatility compared with the dollar or the pound."

Elliptic's clients can choose their own liability limit in sterling up to £5,000 (€6,000) and pay 2% of the annual total in Bitcoins for the service.

Although Elliptic's clients are mainly individuals looking to safeguard their Bitcoins, it has also been approached by a mixture of companies.

Robinson thinks the future looks positive for Bitcoin, particularly in the retail sector. "If you look at retailer acceptance over the past 12 months, it's absolutely soaring," he says. "Overstock.com [a US online retailer] accepts it. Even our law firm is considering accepting it. I believe more and more retailers are thinking about taking it seriously."

Overstock.com chief executive Patrick Byrne declared the company made $130,000 in sales through 840 orders from Bitcoin users in its first day of accepting the cryptocurrency. Most of these orders, he claims, were made by new customers.

To mitigate the volatility of Bitcoin and reduce exchange rate risks, Overstock.com entered into a deal with digital wallet provider Coinbase, which exchanges the virtual currency into fiat (ie legal) money as soon as the Bitcoins are received.

The major benefit to businesses in the retail industry of accepting Bitcoin payments is cutting out the traditional 3% transaction fee charged by payment providers. Coinbase, which serves about 19,000 businesses, charges a 1% transaction fee.

Garrick Hileman, economic historian at the London School of Economics, believes Bitcoin's real potential is not as an alternative to the pound or dollar but rather as an alternative financial system.

"Coinbase and similar businesses are charging 1% in transactions fees, which is a significant saving as Visa and Mastercard are running trillions of transactions through their systems at about 3%," he says. "There's a saving of several hundred billion dollars that businesses and consumers could collectively realise through an alternative payment network."

A digital currency specialist known as Crypto Evangelist believes the potential for increased profits by adopting Bitcoin is too good to ignore. "The low cost of transaction fees is already enticing businesses to implement Bitcoin payment systems into their retail models. Saving 2% on transaction fees can mean a lot in the retail environment today, where margin is everything.

"In today's tough retail market, it's about reducing the costs of the middleman, increasing margins and being competitive by passing on savings to the consumer."

Support network

Although the current business opportunities for Bitcoin may seem narrow, Hileman believes powerful support from the world's leading venture capitalists suggests the cryptocurrency will be around for a long time.

"The fact is Fred Wilson, Peter Thiel, Marc Andreessen and Jim Breyer – some of the top venture capitalists who got the »

» world to tweet and use Facebook, and have mastered the art of changing user behaviour and driving technology adoption on a mass scale – are supporting Bitcoin in a major way," he says.

Hileman is convinced this vote of confidence will advance the development of Bitcoin as either an alternative currency or financial system, but he acknowledges that the diversity of taxation laws around the world is making it hard to gain wider acceptance in the business world.

While most countries are deciding whether Bitcoins are deemed a currency or assets, some have banned it. In Russia, for example, trading Bitcoins is prohibited.

Droese is in no doubt as to why this is. "[Bitcoin] is artificial, and in its artificial world of finance, nobody has any real control because there is no link to direct commodities or service vendors. This is why prohibition is the only thing that works," he says.

Considering options

In December 2013, the Chinese Central Bank restricted financial institutions from handling Bitcoin transactions although individuals can use Bitcoins.

The UK government is still considering its options, but Deloitte head of tax policy Bill Dodwell says it is unlikely to make any drastic decisions. He believes Bitcoin will continue to be regarded as an asset rather than a currency.

"I'm not sure we can expect an immediate change here. There are a lot of other issues around Bitcoin, so I'd be surprised if it were recognised as a currency," he says. "If it were, the difference for businesses would be that gains and losses would be taxed as income rather than capital."

The issues around Bitcoin may discourage many businesses from getting involved, but the demand for the cryptocurrency and places to spend it cannot be ignored.

One online business began to accept Bitcoins for its services in December 2013. Adult website porn.com says that by mid-January, 25% of its sales were paid for in Bitcoins. The anonymity that comes with Bitcoin transactions, rightly or wrongly, makes it perfect for adult content services, which account for a large portion of the most visited websites worldwide and for which discretion is considered paramount by users.

The current risks associated with Bitcoin will change and develop in time as governments grapple with taxation laws and cyber firms work to protect digital wallets from criminals. But Bitcoin's valuation will ultimately determine its strength.

Crypto Evangelist believes Bitcoin has a strong future and is an inevitable consequence of the internet's growth. "Bitcoin is a natural and much-needed innovation of the web. A decentralised global communication system such as the internet needs a decentralised global solution to payments and consensus. Criminality and corruption are created by bad actors within any system. Bitcoin's motto is Vis in Numeris [Trust In Numbers]."

Dodwell believes Bitcoin has the potential to be considered a viable material for trade, just as gold, but tighter regulation is required if it is to be more widely adopted across the business community.

"The point about it being like gold-dealing is that there are gold smugglers, but it is quite a well-regulated business. It's the regulation and traceability that is the key to any cryptocurrency really taking off," he says.

Bitcoin's supporters are optimistic. Elliptic's Robinson says: "Offering things such as insurance and derivatives markets will help stabilise the price of Bitcoin."

Hileman believes the meeting of the world's top venture capitalists and technological minds is a recipe for success. "With this many smart people as passionate and as excited about it as they are, something interesting is going to happen here."

Hacker agrees and believes future investment into Bitcoin will enhance the network and iron out its flaws. "I am absolutely convinced that we can expect to see the value grow and the investments into these networks will build a stronger platform."

Droese remains sceptical about Bitcoin's potential to become a major currency and believes its real value lies within criminal circles. "It is untraceable and you can make transactions across borders anonymously – all these ingredients are perfect for money laundering, which is criminal," he says.

Nevertheless, as large organisations such as Google, Amazon and eBay start to consider how to incorporate Bitcoin into their businesses, it may be time to take the development seriously. **SR**

'There are a lot of issues around Bitcoin, so I'd be surprised if it were recognised as a currency'

Dill Dodwell, Deloitte

How does Bitcoin work?

Bitcoin is an electronic peer-to-peer payment system that services the trading of virtual currency.

Bitcoins are "mined" using expensive software to solve complex data algorithms, likened to the process of searching for new prime numbers. Systems that solve an algorithm are rewarded with a block of Bitcoins that reduces as more are released into circulation. Because algorithms are solved one at a time, the mining of Bitcoins is a competitive process.

The number of potential Bitcoins in circulation is restricted to 21 million. Currently, about 12 million are in circulation and because of the increasing difficulty of algorithms and decreasing number of Bitcoins rewarded to miners, the last Bitcoins are predicted to be released in about 2140.

Payments and transfers should be updated on the "block chain" – an integral part of the Bitcoin system, which traces every Bitcoin to prevent double-spending. Bitcoin users traditionally use digital wallets to store their Bitcoins, which use public-key cryptography.

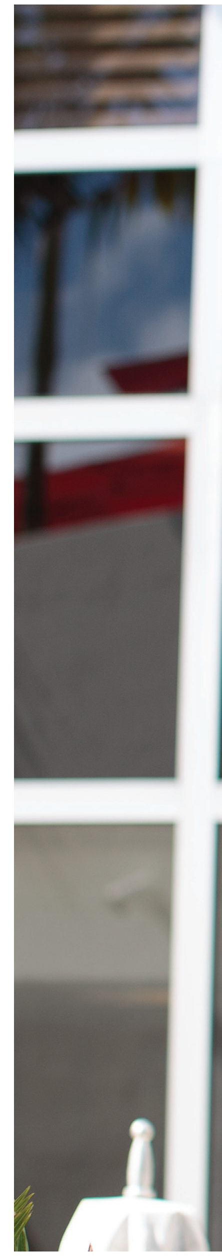
Bitcoin supports anonymous transfers as users can withhold identifying information but each Bitcoin is tracked on the "block chain", which keeps an account of current and past locations of each Bitcoin.

The market valuation of a single Bitcoin on exchange site MtGox rose from about €200 (£164) in November 2013 to €882 by the start of December and fell to €428 before the start of 2014.

A MATTER OF FACT

PROFILE: STEPHEN CROSS

Analytical ingenuity is fuelling Aon's journey into data research and innovation



FOR A MAN WHO SPENDS almost his entire working life travelling, Stephen Cross looks remarkably relaxed as he arrives for *StrategicRISK*'s photo shoot in Miami Beach.

Despite the venue, it is clear Cross means business and he seems as much at home here as he does in the downtown headquarters of a major global corporation in any big city from London to Singapore.

As chairman, Aon Centre for Innovation and Analytics & Aon Global Risk Consulting, as well as chief executive, Aon GRIP Solutions, not only does Cross have several titles to bear, but he also has a number of offices scattered in various locations around the world.

As a self-confessed data junkie, Cross scours the globe on an almost continual basis in search of satisfying the basic craving that screams relentlessly inside all addicts – his next fix. That means information. Lots of it.

Cross's life is driven by data and he admits the need to feed his habit constantly. It is essential mental fodder for a human super-computer who, along with his various teams, processes ceaselessly the outcomes of thousands of machines worldwide into something cogent to help businesses understand and determine better their risk strategy.

Aon started what Cross calls the company's "data journey" in 2008. Underpinning everything was the idea of differentiation and making Aon stand out "in a brokered world that has two basic segments: pure transactional brokerage versus a start-to-finish, end-to-end type of financial risk management house", says Cross. But what began as an exercise in effect to "see what we could do" has since consumed his life and transformed the business beyond recognition.

"We knew we had all this data on the risk side," says Cross, "and we looked at the data points we could capture really easily and globally that we could start doing some analytics around. Then we started to think about where this could lead us."

The early focus on property and casualty, financial lines and marine has now expanded to 51 lines of business. "We are tracking more than 1,200 insurance companies, we have 238 major cities around the world and 169 countries where we underline risks. We have $85trn (€618bn) of limits across all of our books of business and that is capping out your uncapped exposure. Every day millions of dollars of additional information and quotes go into the system and it just keeps growing."

Cross possesses an encyclopaedic mind that appears to operate most effectively somewhere along the peripheral curve of what is known, while simultaneously assimilating another novel insight for consideration.

Numbers are important, but he is quick to point out that while capturing what is often described as Big Data is "interesting in itself", it is what you actually do with the information – making sense of it through analysis – that is most important.

The seriousness of Aon's move into data six years ago was signalled by the establishment of an innovation centre in Cross's home country of Ireland. But it was a challenge finding a technical assessor with the right level of core competence because "nobody had done anything like what we were setting out to do".

Eventually, Cross discovered what he was looking for in the world of academia – an area into which the company is now firmly embedded, with working relationships embracing such organisations as the renowned Wharton School at the University of Pennsylvania. But it was elsewhere within the Ivy League that Cross turned to first. He hired Dennis McLaughlin, a mathematics professor at Princeton and "an absolute genius", as Aon's first chief executive of innovation and analytics. By bringing in an outsider to the insurance world, Cross set the tone for the entire recruitment process. He wanted individuals who were "totally different" and not "contaminated with a history of property, casualty or marine".

Instead, Aon handpicked like-minded souls from the financial world who specialised in data, in particular in its architecture and structure.

Using Aon's vast global client pool, the team started to capture information so it could be disseminated, processed and understood – although that was sometimes easier said than done "because Aon is still a product of more than 450 acquisitions over the past 25 years and we hadn't got all the computer systems linked up".

No room for error

Purity is also a crucial factor and the company invested in a cleansing facility in Shannon, Ireland, to root out any information errors. "Some of them were glaring and some of them were not," Cross says.

He soon realised however, that no matter how clean this data was, it was not enough. "We thought that it was interesting but also very backwards-looking," Cross says. "We wanted to get real-time data so we started to get our brokers aligned with putting in the quotation data in a prescribed format."

Billing data was broadened to include various other quotes on the same risk. "We thought it would be more useful to know not what the absolutes were but the variables," Cross says. "We thought that once we built that, we could capture all the broking quotes. We know which markets are quoting which prices for which risks and we could easily analyse and determine that market A is quoting on pharmaceutical liability and at this point market B is here, market C is here – this could be very interesting for our clients because we will actually be able to align our clients' risk appetite to the markets that are most suited to the risk. So that was the lofty expectation we started out with and that we have since achieved."

This was not the limit to Cross and Aon's data ambitions, however, and the team is constantly refining and developing new and more ambitious goals.

Cross is the ultimate deep thinker and his ideas lie at the operational heart of the fastest growing brokerage in the world – a unique and quite extraordinary position within a business that has upwards of 65,000 employees.

As his role gets bigger, so do the numbers and also the possibilities. "We are working on a project with one of our clients »

CV

- After seven years working in the insurance industry in Ireland, Stephen Cross joined International Risk Management Group (IRMG) based in the Cayman Islands in 1990. He moved to the US in 1995 to develop global sales and marketing for IRMG, which became part of Aon in 2000.
- In addition to several risk and insurance-related qualifications, Cross attended the Advanced Management Program at Harvard Business School in 2006.
- Previous roles at Aon include responsibility for retail operations in Ireland, the Middle East, Russia and Kazakhstan and chief executive of Aon Global Insurance Managers.

Dealing with the facts

Prediction based on existing facts is part of Cross's core ethos. There are no surprises in life – just events people don't want to foresee. No "nonsense" about black swan theories.

Everything is somewhere on the radar – the key is identification. For example, the earthquake and tsunami that triggered the Fukushima disaster were predictable, says Cross.

"I suppose the real question is: is there something out there that we have yet to see that has never happened before and we didn't envisage it?

"In practical terms, people talked about the volcanic cloud over Iceland but such events happen all the time. There have been many out in Asia and, in 2012, they had to divert around most of the Latin American air corridor because of something that was boiling up over Peru.

"People refer to these as black swan incidents, but I actually cannot think of anything that I would consider a true black swan.

"A power outage for the US? That would just be a much bigger incident than has already happened in Los Angeles or New York.

"If you sit down and think about it you really have to come up with something that is so outlandish to be a black swan.

"From our point of view, as an adviser, we have to help our clients think around what is practically conceivable. And our responsibility has extended in recent times to think about risk constellations; how one can have an impact on another, which can affect another – a domino effect.

"If you have a weak control structure within a company, you are likely to have people behaving badly. They could be harassing employees, they could be fiddling the books, they could be putting out misstatements on social media. By having a weak control environment you have exposed yourself to certain characteristics that could actually bite you from different ends.

"Some risks can open up a lot of avenues of loss, and that is where real enterprise risk lies."

'We are pulling away into preventive and predictive space versus the backwards-looking reactive space'
Stephen Cross, Aon

What are the biggest risks for businesses?

Complacency Out of sight, out of mind. People become really complacent about risks. So how do you take your data and help your clients to not be complacent? People get complacent about compliance, about pricing – it happens all the time. This raises the question as to how we use our data and analytics to make sure our clients are acutely aware of what is important to them and not what the flavour of the day is.

Changing regulation You can be guilty of something that you can do perfectly legitimately today and then somebody decides it was a bad thing and you are tarred. Even if you are not subjected to criminal charges, your reputation can be damaged. That is a risk and really you cannot do much about it.

Getting left behind At Aon, we consider ourselves to be innovators and that others follow us. But in terms of failure to keep up, you don't even have to be a leader, you can be a follower and still you can continue to fall further behind.

» where we have 10 million data points," Cross says. "We are trying to define what the best characteristics would be for an employee in terms of absentee rates and job performance. This group is good at ranking employees and doing appraisals and there are characteristics about how far people live from where they work, how many jobs they have had, what their education is, age experience in the industry group and so on, which means you can identify criteria that are suggestive of who your best employee individuals are, how long they will stay with you and so on. That is hugely helpful to an organisation."

Preventive measures

Cross says Aon is continually converting data through its analytics into "valuable insights for our clients to probe them around risk to make them think about things that they otherwise would not think of". In doing so, they are putting the emphasis firmly on prevention rather than cure.

"We are pulling away into preventive and predictive space versus the backwards-looking reactive space," he says. By adopting a broad yet focused approach, this could even change the entire dynamic of the way in which Aon operates within the broking world.

"We are not where everybody was five or 10 years ago, with people looking at manufacturing risk, financial risk and transportation risk all separately. We now have insight into this as a portfolio of risk – and the diversification of risk that occurs within that portfolio is balanced.

"Underwriters hate it when brokers suggest a price for risk because they think as underwriters they should be dictating this. I see us going as far as understanding and presenting a basket of risk to the market and not just a risk in isolation. It is almost like a mutual fund."

With so much data, staying compliant across multiple national jurisdictions with differing regulatory practices presents a challenge for the firm. "In Germany, for example, you are not allowed to hold personal data on any database outside the country, so we hold all that information inside Germany," says Cross.

To limit data concerns Cross says Aon uses only aggregated, unnamed, unexposed data and removes identifiers. "We are unbelievably aware of the compliance requirements we have worldwide. It is expensive but this is where we have advantages over others."

Compliance regulations change constantly and Cross does have a degree of sympathy and understanding for those who fall foul of them through minor indiscretions.

"It all comes down to intent," he says. "Why am I seeking this information? Is it for your benefit or to misuse it for my benefit? That is the crux of the question." Cross believes that data, as well as human capital, is the most valuable asset a business owns. This will increase further in the future when companies will be judged on how much information and insight they possess.

Controlling this is crucial. "We will soon be living in a separated world in terms of data," says Cross, who firmly believes this is where Aon will hold the advantage.

"We're in a different place because of what we have in terms of data – and it is an investment." SR

‘Risk managers deal with an ever-increasing portfolio of threats that are more difficult to protect against’

OPINION MIKE JONES

EDITOR, STRATEGICRISK

HUMAN CAPITAL IS THE SINGLE GREATEST ASSET OF ALMOST EVERY ORGANISATION. Without the right people businesses would cease to exist. They are the innovators and the force that makes everything happen. They are also its biggest enemy.

Risk managers can advise companies on taking all precautions necessary to guard against the broadest spectrum of threats but these measures are only as effective as the people within the business allow them to be. Purchase the most sophisticated cyber defence system available and you could be forgiven for sleeping easier at night. But what if someone in IT failed to install it properly, missed a service update or switched it off deliberately? That business would be rendered vulnerable to a cyber breach and could be in a worse position than having no protection at all because it would be assumed to be in place.

Perhaps this is an extreme example, but it is more than mere hypothesis and companies have been left open to attack by exactly such failings. Reality is sometimes even more basic. Before the advent of cloud computing one major international corporation came close to losing the entire contents of its server room to a gang of opportunist thieves after a member of staff left an external door open. A common cyber danger comes in the realm of bring your own devices, which are becoming increasingly popular as firms look to save money on hardware. Such financial cutbacks are often short term and short-sighted as they can leave companies exposed through individuals using equipment they have purchased independently that is not protected properly. Left unregulated, an entire network can be compromised.

Assumption, presumption and complacency are a fatal combination. Failing to undertake simple checks can bring down the most comprehensive defence mechanisms.

Stories abound of company insiders being ‘bought’ by criminal cyber gangs to extract information. In some cases, individuals act for their own financial gain, in others, they are responding to coercion. Such incidences do happen although they are relatively rare. A more likely danger is the disgruntled employee – the one who lost out on promotion or feels undermined by their boss or colleagues. There are many such employees and most will continue to act rationally and behave within normal constraints. Some, however, will seek to punish and damage. In these cases, their acts of vengeance can start out relatively low key to see if it gets noticed but eventually escalate into something far larger and more sinister.

Computer systems make the perfect target for employees who want to hurt a business. They don’t need to hack into it, they already have access and the smart ones will know that they can operate largely undetected, provided they are subtle. Tiny changes can still have a devastating effect. What if that employee accessed a spreadsheet and moved a couple of digits to the left? They have just increased order levels ten-fold but who would notice until it was too late?

Such behavioural threats are by no means limited to the cyber sphere – white-collar fraud is on the increase all over the world. Often, the perpetrators appear to be the least likely to offend – indeed many frauds are carried out by trusted members of staff with long service records who are skilled enough to cover their tracks. A not insignificant number of such fraudsters are women – those given the power to sign cheques or use credit cards on behalf of bosses with no time to check where the money is being spent until accounts detect the emergence of a large financial black hole. Such behaviour can put an SME out of business but it can be also damaging to a large multinational, perhaps not in terms of the bottom line but in terms of reputation. This is why many such thefts go unreported and are dealt with internally. Ultimately, that only adds to the general problem by inadvertently encouraging others to act fraudulently as they do not fear being caught. It also stops businesses learning from the mistakes of others and implementing systems to prevent this type of activity.

Many frauds are carried out by trusted members of staff with long service records who are skilled enough to cover their tracks

Trouble generated by staff can manifest itself in any number of ways within a business – a rogue email, an employee getting drunk and spilling company secrets to a rival or even just disgracing themselves in public. In our world of fast-moving social media, a salacious incident that may once have been seen by a handful of people with no connection to that employee or company can become a global reputational firestorm in a matter of minutes.

Risk managers deal with an ever-increasing portfolio of international threats that are becoming more sophisticated and, as a result of their complexity, more difficult to protect against. However, many will remain little more than theoretical. The biggest dangers are often more simple and much closer to home – and these are ones that are overlooked mostly. **SR**

'When the pressure to cut costs comes on, the temptation to cut corners grows'

OPINION
ANDREW LESLIE
EUROPEAN EDITOR, STRATEGICRISK

ON 15 JANUARY A YEAR AGO, BRITISH CONSUMERS WOKE UP TO THE revelation that Irish food inspectors had found significant amounts of horsemeat in beefburgers and other processed foods stocked by several UK supermarkets. The resulting scandal was followed by the usual crisis management measures, with the big retailers promising to improve their testing, be more careful with their sourcing and launching marketing campaigns to regain consumer trust. But a year later, sales have not recovered, with frozen ready meals still 6% lower than in December 2012.

What particularly concerned consumers was that the horsemeat contamination was not confined to one brand or one retail outlet. Rather than being limited to a single guilty party, the horsemeat scandal made it seem that the industry as a whole could not be trusted. Despite the attempts of unaffected retailers to differentiate their products from the rest, that distrust has lingered on.

The reason for many different brands being affected lay in the complexity of the supply chains in the European food processing industry. No matter the branding of the final product, somewhere down at the end of the line manufacturers were sourcing cheap ingredients from the same suppliers, maybe half a continent away. Moreover, when, through fraud or ignorance, horsemeat appeared in the supply chain, that fact became immediately apparent, trashing the idea that one product was in some way different because of its branding.

This problem is not confined to the food industry. The drive to seek out suppliers who provide the best combination of reliability and cost makes it inevitable that firms will end up looking to the same people. While it may be possible to negotiate exclusivity one or two steps down the line, somewhere there will be a company that is selling to several clients, probably because it is the cheapest. When the pressure to cut costs further or fulfil orders faster comes on, the temptation to cut corners grows. Where that results in a scandal, the entire industry can be affected – the innocent together with the guilty.

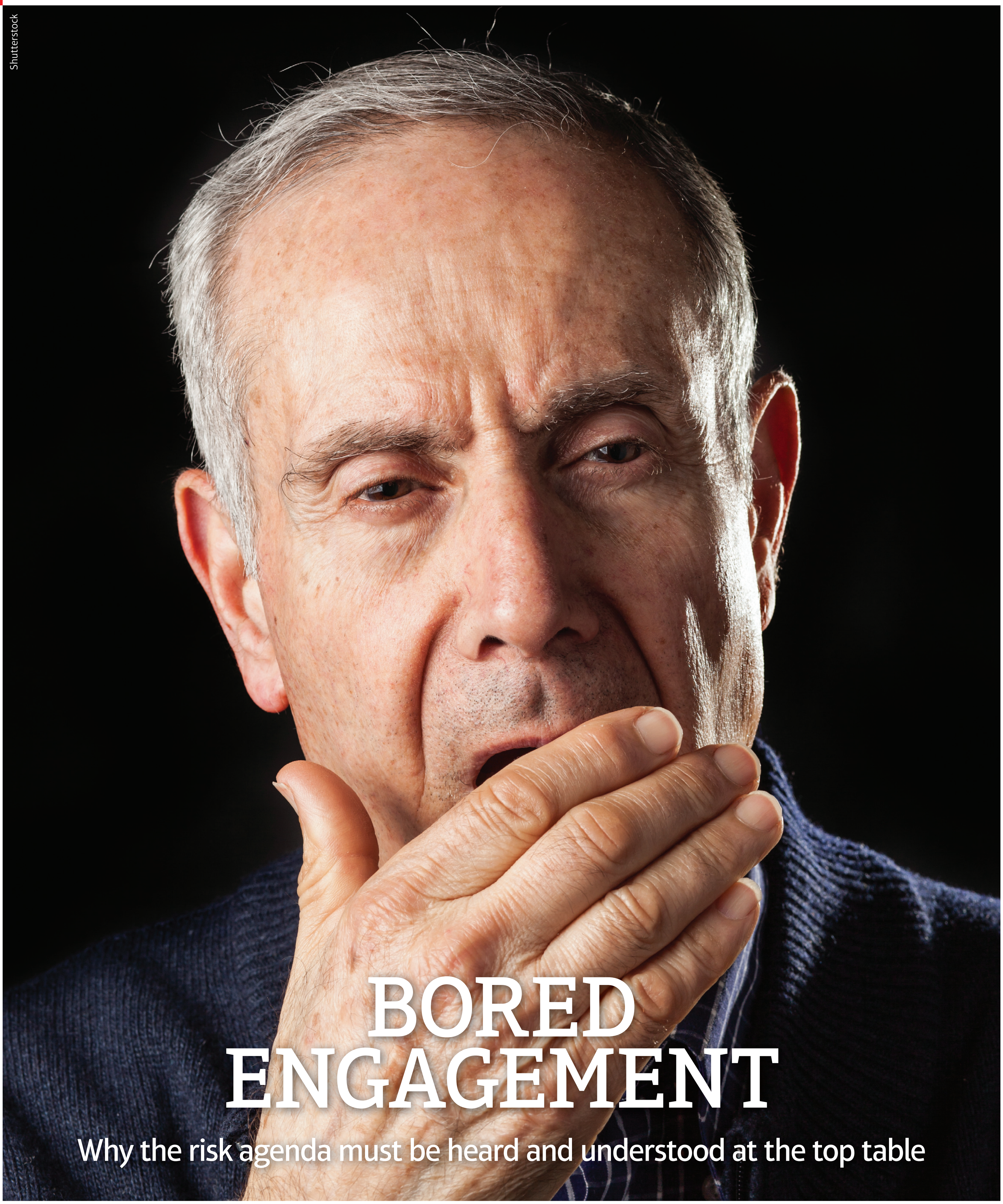
The various sweatshop scandals in the textile industry continue to haunt fashionable brands. First it was child labour; then came the collapse of the Rana Plaza building in Bangladesh in 2013, which killed more than 1,100 workers. At least 20 European and US clothing brands had links to that factory. Such is the nature of the global, integrated supply chain.

It is not just risk to reputation that arises out of this tendency of the supply chain to end up in particular geographies or particular low-cost environments. Natural disasters pose an equal threat. Thailand produces about 25% of the world's hard disk drives; the 2011 floods there caused huge disruption to IT firms' production schedules. The tendency of Japanese car manufacturers to source from Thailand also meant that the entire sector was disrupted. Business interruption cover can go some way to mitigating such losses, but it will not make up for the reputational damage.

It is not as though risk managers aren't aware of the problem. Enterprises take endless initiatives to police their supply chains by inspecting factories or joining schemes to improve working conditions. Elsewhere, they build resilience by diversifying their sourcing, seeking out back-up suppliers or even buying up as much of their own supply chain as they can. But so long as competitive pressures force companies into undercutting wherever they can, the risk remains. There is no easy solution. **SR**

So long as competitive pressures force companies into undercutting wherever they can, the risk remains

RISKS



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BORED ENGAGEMENT

Why the risk agenda must be heard and understood at the top table

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RAISING AWARENESS

LIKE MANY RISK SPECIALISTS, Daniel San Millán del Rio, risk manager at Spanish infrastructure giant Ferrovial, is in no doubt about the most important step to making an organisation risk-aware and resilient. "You have to convince the board first," he says. "If you go down to the shop floor without enough support from the board, you are dead."

But the process of persuading the top table to take risk management seriously is often far from straightforward. Attempts to engage with hostile board members can be frustrating – seemingly almost impossible. This is often a result of the board's suspicions about what is, in many cases, a relatively new function in many businesses.

Further, the situation is frequently made worse by fundamental differences in outlook between the two sides.

"There certainly is a problem between the board and the risk function," says Michael Mainelli, executive chairman of commercial think tank Z/Yen and emeritus professor of commerce at Gresham College, London.

"The board is dominated by the financial statements. Two characteristics of the financial statements are that they are backward-looking and they use discrete, single numbers. Risk is forward-looking and deals with clouds of probabilities. Within firms, there is almost always a similar tension between the finance function and sales. Sales people look to the future and can accept the uncertainty of wide ranges of possible outcomes. Finance wants a single confirmed number."

This tension can be exacerbated by the way risk managers talk to the board. International corporate governance and board development consultant and visiting professor at Cass Business School Bob Garratt says: "Risk managers tend to try and make their reports more serious by using a lot of mathematics. They are getting themselves into the unfortunate situation that many economists have got themselves in: an over-reliance on maths at the expense of looking at the irrational, human aspects of their business.

"You can begin to convince yourself that risk management is a science and it's not. There are no irrefutable laws. It's all about interpretation – and this can change. The world changes."

Common purpose

In a shifting and often confusing economic landscape, finding a common purpose is essential. Boards need to understand that risk management is an essential ally, both in defining strategy and the business model. If the risk management team and the board members are doing their jobs properly, their functions should be closely aligned.

Problems often arise when the board is not aware about how useful risk managers can be in developing strategy and

interrogating the business model or when risk managers let themselves get bogged down in operational detail and fail to make themselves accessible to the board.

"A lot of the risk problems companies have can be summarised as a lack of understanding by boards and a lack of communication by risk managers," says Charles Baden-Fuller, centenary professor of strategy at Cass Business School.

This lack of understanding does not just make for a less efficient, less dynamic firm. It can have catastrophic ramifications. "Look at the banking crisis," says Baden-Fuller. "Most people assumed the banks were doing commercial lending, but they were, to all intents and purposes, running hedge funds.

"Before the crisis, most of the risk management functions of banks were designed to deal with commercial lending, not running a hedge fund and engaging in speculative activity.

"This is a classic example of boards getting involved in a business model they didn't understand, with risks that they didn't understand and not communicating any of this to the risk management function."

Another big problem is that board members are highly reluctant to get involved in operational details. So, if risk managers bring too much detail to board meetings, they risk alienating their superiors.

"One of the cardinal rules for a board is that you don't micromanage the executive from the boardroom table, and a lot of boards resent risk [managers] because they are always – or at least always seem to – drag the board members into detailed managerial decisions that are not their role," says Garratt. This leads to a feeling of resentment towards risk management, which is perhaps one of the most consistent problems in Europe when it comes to securing board-level engagement with the profession.

Although risk managers have developed their practice – and it is rare to find anyone in a corporate risk environment who doesn't understand the importance of communicating their value upwards – that message is not always getting through.

Colin Coulson-Thomas, professor at the University of Greenwich and a director and member of ACCA's governance, risk and performance global forum, sums up the problem. "Many risk managers are just seen as negative and an overhead cost – people who are risk-averse, people who hold things up, people who report problems and bring bad news," he says.

"In some circles they have a terrible reputation. But by becoming more active, risk managers can become much more vital to an organisation. By putting together solutions, they could change how they are perceived."

Getting noticed

To get the attention of the board, risk managers need to make sure that what they are doing is not just about processes and checklists; it is about what's going on in particular areas, as well as on the frontline.

"This doesn't mean top-down micro management. It just means giving people the right tools and helping them," says Coulson-Thomas. "It's what I call 'new leadership' – getting away from the top-down planning and putting more emphasis on bottom-up support."

More important, however, the board must understand that just having a risk management function in place should not amount to the totality of their approach to risk. They need to fully engage and use the talent they have and risk managers need to communicate this.

"There's a danger that by creating a risk management function and having people with the job titles and responsibilities, [the board] can take its eye off the ball and think things are covered," says Coulson-Thomas. "What you really need is everyone in the company thinking about risk – particularly those on the frontline and in certain work groups."

It is the responsibility of the risk management team to make sure this takes place.

"So much is happening so fast and our job is to make sense of it all and to put it into a form that will enable managers to make decisions," says Adrian Clements, general manager for asset risk management at multinational steel manufacturer ArcelorMittal.

"We need to create the point of conversation and negotiation between everyone in the business, so that we can respond to risk together," he adds. "All too often, the gap between the boardroom and the shopfloor is getting wider and wider. We need to close that gap."

Coulson-Thomas says: "Risk management needs to detach itself from reporting and attach itself to ways of helping their organisation to respond in a flash. Potentially, this is a massive opportunity. Risk managers have a strategic opportunity to put themselves into a great position." SR

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BETTER UNDERSTANDING

TO CREATE A MORE EFFECTIVE relationship between the risk function and the board, risk managers must stand up and show their bosses that they are not simply insurance buyers, as some senior leaders perceive them to be. For their part, boards need to realise the value of the talent they have at their disposal "for the simple reason that without it, your business will die", says Bob Garratt, corporate governance and board development consultant and visiting professor at Cass Business School.

"The world is so turbulent and uncertain that there is an increased urgency to have at the top of your organisation – the board, not the executive – a group who are frequently horizon-scanning and bringing their thoughts on what is changing into the organisation for discussion," says Garratt.

"Most businesses, most boards, don't spend a lot of time thinking about uncertainty. In fact, they are terrified of doing so. They don't have any means of doing so, never mind ways of bringing their information into the business."

It is in this space that risk managers can prove their value and improve their relationship with the board. "We all have complex supply chains that are slow to adapt and lean management teams that mean there are too few people in place to spring into action during a crisis," says Adrian Clements, general manager for asset risk management at steelmaker ArcelorMittal. "If you ask one section of the business 'How long until we are back on line?', you will get one answer; ask another section and you'll get another. Unless you [as a risk manager] combine bottom-down and top-up effectively, you cannot resolve this contradiction."

By finding their place at the crossroads between senior leaders and the executive, risk managers can demonstrate their importance to the board. An increasing focus on interrogating the business model at the heart of a firm, for example, demands the active involvement of the risk function.

"The risk management function has to deal with a whole host of risks – political, economic and so on – but the key issue for them is to do with business model choice," says Charles Baden-Fuller, centenary professor of strategy at Cass Business School. "If the risk management function has good people, its job is to tiptoe up to the board and say: 'Excuse me, perhaps I can help you analyse and then communicate some of these risks, because we both share the same agenda'.

"This can be quite a difficult process. We all understand there is a hierarchical relationship between the risk management function and the board of directors. If the board has a good relationship with the chief executive and the chief executive has a good relationship with the risk management function, this process can be simple. Of course, this isn't always the case.

"Risk management is difficult, but many boards do not have the resources to fully analyse the problem. They need help. Often, there need to be clear lines of communication between the risk management group (suitably resourced with strategy expertise) direct to the board, especially around discussion of the business model."

To do this effectively, the risk management function needs to look at what – and how – it communicates and really challenge the board's approach. Colin Coulson-Thomas, professor at the University of Greenwich and a director of ACCA's governance, risk and performance global forum, says: "There is a whole range of people-reporting risks rather than doing much about them. Risk managers need to up their game. They need to shift their emphasis from planning and strategising to implementation and action."

Daniel San Millán del Rio, risk manager at Spanish infrastructure company Ferrovial, agrees. "Senior managers need to know that ERM [enterprise risk management] is a tool that will put a huge amount of information at their fingertips, on their laptop, their iPad, wherever they are – in a plane, in Africa, in Asia. This is the tool that will enable them to make the right decision.

"You have to explain what you are going to do. Everybody has to understand that this is not just another process – we have enough of those. It is a special project."

Advantages of ERM

The focus should be on key and frontline work groups that expose an organisation to risks and give them the support to deal with risk. Risk managers should make it easy for them to do what is required.

When risk managers talk to the board members, they should explain that a great ERM approach will make their lives easier and their decision-making more effective.

"The key issue is to convince the board that this tool is going to provide them with the information to make the correct decision on time," says San Millán. "If you have a business with 100,000 employees in 40 or 50 countries, it's not easy to always know what's going on with the business line, and the board knows this. But with a properly integrated ERM, it has all the concerns of its people in its hand. It can make quick decisions before a risk becomes a loss."

But risk managers shouldn't report anything without suggesting how to deal with it. "If a board meets once a month, it can't add much value if it is dealing with huge wodges of analysis without suggestions for action," says Coulson-Thomas.

It's also important to note that since 2008, risk has increasingly been at the heart of emerging legislation on corporate governance – another area where risk managers can prove their value and develop the quality of conversation with the board.

"The new version of the corporate governance code has a section on the regular interpretation of the business model by the board – and this is quite revolutionary," says Garratt. "Risk managers should be aware of this. Everyone needs to understand the purpose of the business – and from that the business model, and from that horizon-scanning and risk management."

In addition, companies are increasingly being asked to enhance traditional ways of reporting and adopt triple-bottom-line reporting, opening up another new area for risk managers,

in the theatre of governance. Triple-bottom-line – an accounting approach developed in 1994 – requires companies to prepare three bottom lines. The first is the traditional measure of corporate profit – the profit and loss account; the second is the company's 'people account' – how socially responsible it is; the third is the company's 'planet' account – a measure of how environmentally responsible it is.

"International law will increasingly be requiring these things. And the question is: how are we all going to muck in and make this happen?" says Garratt. "In emerging economies, we are seeing the introduction of a licence to operate and the decision to grant these will be based on these principles of triple-bottom-line reporting. Risk is at the heart of it all.

"These are interesting times," he adds. "A lot of the traditional ways of operating are up for grabs."

Another big concern for the board is that risk managers stay on the right side of the law. This means avoiding failures in corporate governance, complying with the UK Bribery Act 2010 and making security risk "everyone's responsibility", says Damian Taylor, region security director at Control Risks International SOS. "Because when things go wrong, the board is in the firing line." **SR**

Expert insight: Future boards will focus on uncertainty rather than risk

The heart attack of the 2008 financial crisis led to emergency surgery through quantitative easing and a very fragile recovery. Now public demands for a stronger recovery fly in the face of the risk-averse stance taken by many boards and executives.

Two powerful trends will force boards and top teams to take more risk, and do it more transparently. The first is the call for observable competency among leaders. The shock of finding that those at the top are no more than ordinary has led to great anger – the public will be paying, at least for a decade, for mistakes taken by boards and senior executives.

Matters have not been helped by the lack of contrition shown by bankers and a reluctance to change. Insurers have been more open and ready to improve. It is hoped the City Values Forum's City Obligation – a return to "my word is my bond" – will have a long-term benefit.

Public demand panics legislators and regulators, who rush out codes and laws that do little to solve problems but enable them to say they have done something. Codes should be treated with scepticism as they usually give mechanical solutions to human problems.

In an era when the business mindset is to be risk-averse, can one create wealth without taking risk? No. Life is risky. Commerce is risky and necessary. Wealth creation requires creativity around opportunities to deliver business effectiveness and productivity to deliver efficiency. How many risk management systems deliver both or even either?

The second issue is the under-performance of boards in the financial crisis. This signals the beginning of the end of the executive-led capitalism that has lasted since the 1920s. The notion that owners do not count and the financial system should be designed to give a free hand to executives is ending. Public anger is forcing us towards a stakeholder-led capitalism.

Such a prospect, barely conceivable 20 years ago, is forcing boards to differentiate their roles from executives. In the UK, this has been accepted since the Companies Act 2006 but poorly enforced. Yet with the arrival of triple-bottom-line reporting, the board will have to take a more policy-formulating stance to cope with new uncertainties.

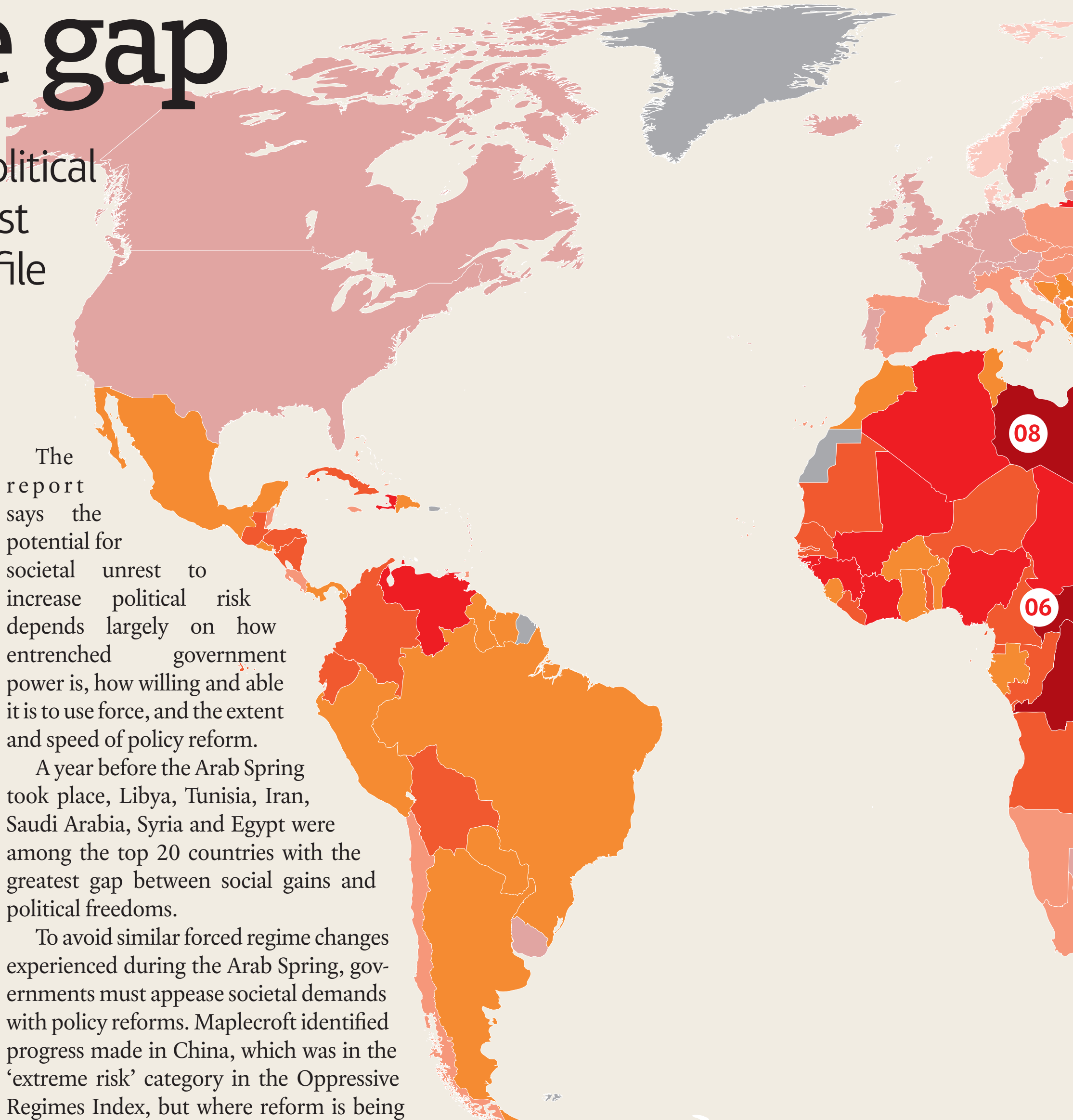
Using uncertainty and tolerating ambiguity is becoming the new norm for directors. Boards will have to cope with uncertainty in their main task – tracking changes in the political, physical, social, economic, technological and world trade environments – to fulfil their legal obligation to ensure business success. This leaves executives to focus on the operational risks from their business model.

Uncertainty and risk must be brought together in a system of continuous business learning, so that the rate of learning is equal to, or greater than, the rate of change in the external environment. That is our challenge.

Bob Garratt, corporate governance and board development consultant visiting professor, Cass Business School

Mind the gap

The difference between political freedom and societal unrest is key to a nation's risk profile



AS POLITICAL freedoms deteriorate, the potential for societal unrest and political instability increases, particularly among growth economies, according to the *Political Risk 2014* map from Marsh and Maplecroft.

The interactive map shows political violence has continued to rise in the Middle East and North Africa (MENA) since 2010, and instability and conflict in the region and in East Africa have led to a global rise in political risk.

Each country's overall political risk was calculated by equating 30 different indices under four themes: governance framework; political violence; business and macroeconomic risk; and societal forced regime change.

The accompanying report identifies high educational standards and IT literacy levels among unemployed and underemployed youths as catalysts for an increase in political risks faced by investors in growth markets.

Where levels of education and IT literacy are high and political freedoms poor, societal unrest is more explicit. As Maplecroft chief executive and founder Alyson Warhurst points out: "The growing risk of societal unrest is driving regime instability and political risk for business, exacerbated by growing disparity between political freedom and social gains."

The biggest disparity between political freedom and social gains was in Uzbekistan (8 in the Oppressive Regimes Index), China (9), Saudi Arabia (11), Turkmenistan (12), Belarus (16), Cuba (22), Bahrain (24), Vietnam (25), Kazakhstan (32) and the United Arab Emirates (42).

The report says the potential for societal unrest to increase political risk depends largely on how entrenched government power is, how willing and able it is to use force, and the extent and speed of policy reform.

A year before the Arab Spring took place, Libya, Tunisia, Iran, Saudi Arabia, Syria and Egypt were among the top 20 countries with the greatest gap between social gains and political freedoms.

To avoid similar forced regime changes experienced during the Arab Spring, governments must appease societal demands with policy reforms. Maplecroft identified progress made in China, which was in the 'extreme risk' category in the Oppressive Regimes Index, but where reform is being implemented effectively and quickly enough to limit societal unrest.

However, in countries that fail to address the disparity between political freedoms and societal gains, governments will attempt to address underlying societal pressures that are symptomatic of increased structural political risk. This may well result in the introduction of policies that are detrimental to business in order to earn support from different social groups.

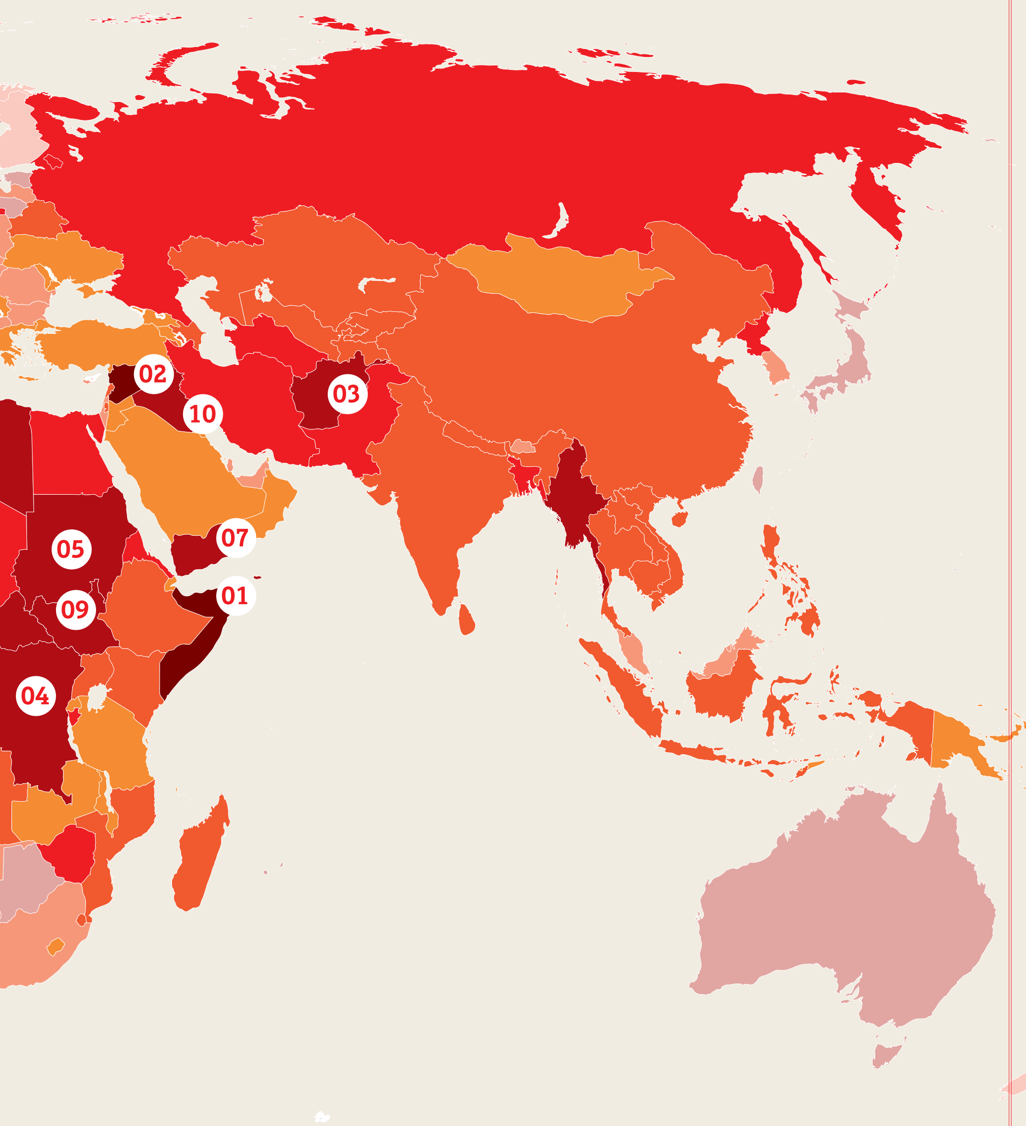
Consequently, resource nationalism, unfavourable tax regimes and demands for increasing local content are some of the typical risks that businesses could face in 2014.

"Expropriation and resource nationalism will continue to characterise 2014 as governments struggle to raise revenue, manage discontent and address economic imbalances," says Warhurst. "The level of resource nationalism will also be dictated by commodity prices."

Events developing in Thailand and Ukraine further highlight the unpredictable nature of political violence and civil unrest. At the time of writing, Ukraine was "on the brink of civil war", while riots and violence were expected to continue as a result of general election uncertainty in Thailand.

While companies can attempt to keep on top of developments in countries where they have business interests, the ability to predict the scale of events, such as those unfolding in Ukraine and Thailand, can sometimes border on the impossible.

This leaves businesses in need of high-quality crisis management. **SR**



POLITICAL RISK TOP 10

1. **Somalia**
2. **Syria**
3. **Afghanistan**
4. **DR Congo**
5. **Sudan**
6. **Central African Republic**
7. **Yemen**
8. **Libya**
9. **South Sudan**
10. **Iraq**

Source: Maplecroft

KEY

Extreme risk
High risk
Medium risk
Low risk

No data

Source: Maplecroft and Marsh

Expert view: A wider geographical span

Over the past year, AIG has seen a significant uptick in enquiries across a broader geographical spread of countries than was previously the case. Clearly, the Arab Spring has focused minds in boardrooms on the potential risks that political upheaval can bring.

No one predicted the Arab Spring. The conventional wisdom was that countries that had stable, if not necessarily desirable, governments would remain in power. Any protest movements in these countries had been successfully suppressed, maintaining an impression of stability.

But the self-immolation of Tunisian fruit seller Mohamed Bouazizi's in protest against police corruption and ill-treatment sparked a wave of upheaval across the Arab world. His desperation resulted from having to pay corrupt officials before being allowed to sell his fruit.

The resulting political instability in North Africa helped focus attention on the associated risks to businesses operating in this region and further afield. Naturally, mitigating these risks has become more important to companies operating internationally.

One view of social unrest and political instability suggests that improved educational opportunities, combined with deteriorating levels of political freedoms, are a prime cause. While this may be a factor, lack of economic opportunity is undoubtedly key.

More recently, we have seen the impact that the US government's tapering of quantitative easing has had on a number of economies. These are the so-called Fragile Five – Turkey, Brazil, India, Indonesia and South Africa.

In Turkey and South Africa, the result has been dramatic rises in interest rates in an attempt to stem the flow of capital back to the US and other rich nations. The knock-on effect has been to stifle growth prospects and economic uncertainty.

In others, the tapering has led to volatility in local capital markets, bringing with it wider uncertainties and growing popular unrest. How this can develop is very difficult to predict. It can be triggered by a relatively low-key event – such as the bus fare increase in Brazil that led to riots last year – and it can be very disruptive to business.

The effects of the US Federal Reserve's decision to start tapering quantitative easing have not been fully realised yet. It is not surprising then that business leaders are increasingly looking more closely at the potential impacts of political risks on their firms and that the geographical span is wider now than we have seen it for a number of years.

Ray Antes, senior vice-president, political risk, AIG

Captive audience

The emerging-market multinational is on the rise – and it has a sophisticated approach to risk management

AS ECONOMIC POWER moves eastwards, tomorrow's captive owners are just as likely to be based in India, China or Brazil as they are to be based in the UK or the US.

Ever since the financial crisis shook up the global economy, it is clear the world is changing. There has been a shift away from the dominance of the mature Western economies towards those in the rapidly developing world. With obvious attention on the BRIC (Brazil, Russia, India and China) nations in recent years, attention is now turning to the MINTs (Mexico, Indonesia, Nigeria and Turkey) as growth in the maturing BRICs slows down. All eight nations are tipped to dominate the world stage by 2050, according to World Bank predictions.

Reflected in this shift is the rise of a new type of global company – the emerging-market multinational. Not only do these organisations have a sophisticated approach to risk management, they are also more likely to consider captive insurance than their predecessors, thanks to wake-up call events and maturing local insurance markets. "Because these markets are developing, there is greater awareness of exposures, and as they become wealthier they become the centre of multinational businesses," says Paul Hopkin, technical director of Airmic.

Among the better-known brands are Tata, ArcelorMittal, Infosys, Oberoi, Aditya Birla, Lenovo, Cemex, Huawai, ZTE, Bharti Airtel, Ranbaxy and Embraer. Several already have captive insurers, particularly to finance their international risks. This includes Tata Steel Europe, which self-insures through its captive, Isle of Man-based Crucible Insurance Company Ltd.

One of the case studies in Airmic's long-awaited *Roads to Resilience* report is Jaguar Land Rover, owned by Tata Motors. "These are international companies located out of developing BRIC-type economies," says Hopkin. "Talking to the risk managers who work for and in the subsidiaries they own, it is clear they genuinely seek to practice the risk management message. The subsidiaries in the UK of companies owned by organisations in BRIC countries are wanting to build a reputation and build good risk management standards right throughout the organisation."

The challenges for captive managers in attracting the business of the BRICs is demonstrating the value self-insurance holds at a time when pricing in the commercial insurance market is so competitive. The influx of capacity from capital markets investors into the insurance industry has put further downward pressure on rates in recent years. In addition, the benign catastrophe year in 2013 means there is plentiful capacity and none of the market dislocations that might have prompted captive growth in previous cycles.

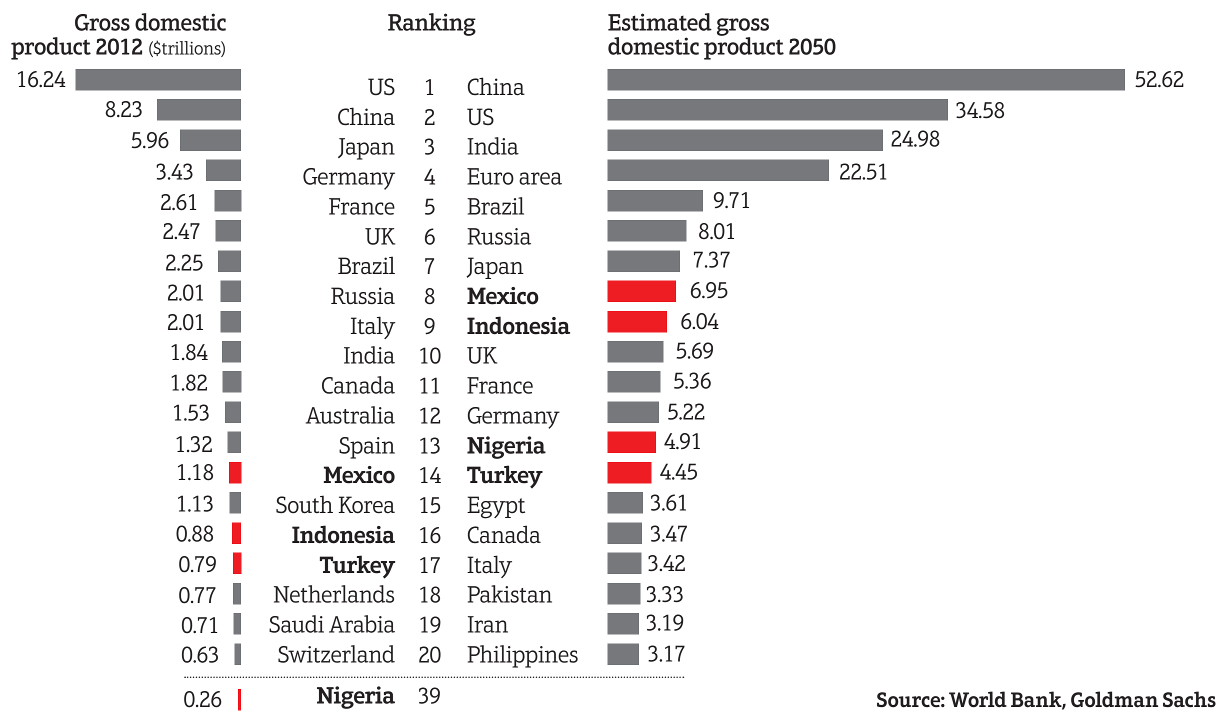
Dealing with closed and immature local reinsurance markets presents another challenge. "The issue with India and China is moving the money out of the country," explains Clive James, group chief operating officer at Kane. "Where we've seen the growth and potential growth is for Indian and Chinese companies looking at their risks outside of those particular countries. The classic would be Tata, which has a lot of subsidiaries globally and is placing its insurance risks outside of India into a captive."

Wake-up calls

While commercial insurance premium rates are soft, particularly in competitive emerging insurance markets, volatility in pricing has also been a feature of the past two to three years. Catastrophe losses have helped to underline the appeal of captive insurance, with reinsurance rates rising dramatically in the aftermath of Asian catastrophes in 2011, most notably the Thai floods and Japanese earthquake and tsunami. These events also illustrated how interconnected the world and its supply chain risks are, with flooded industrial estates in Bangkok causing widespread business interruption.

Captive insurers can help organisations avoid this volatility in pricing and allow them more direct access to the reinsurance market. "One of the reasons why Asian companies have not produced many captives is because the insurance market has been relatively cheap," says James. "That has changed. For example, incidents such as the Thailand floods and political unrest do have an effect on premiums and, in a lot of cases, claims from the Thai floods have still not been paid. That has caused the risk »

Rise of the MINTs



Bermuda woos LatAm

Latin America is holding the attention of the captive community thanks to a steady growth in alternative risk transfer programmes, notes Marsh in its most recent benchmarking study.

Many LatAm corporations are well positioned financially to consider a larger self-insured retention in combination with traditional risk transfer options, and are eager to improve their understanding of the business benefits, operational aspects, and financial benefits of using captives.

"We feel there are some good opportunities in South America provided the captive model works for that country," says Kane's Clive James. "It works for Brazil, but there are still restrictions on getting reinsurance premiums out. You've got to offer it to local insurers first, which does put a bottleneck on reinsurance for captives. But South America generally is a developing area and we see there are some good opportunities there. As an organisation, we are optimistic about how that's developing."

In Latin America, semi-governmental agencies or organisations guaranteed by a government tend to dominate the captive market, with a heavy focus on commodities, according to Nearshore Americas. The obvious options for parent companies in Latin America is to locate their captives in offshore domiciles such as Bermuda, Cayman or Barbados. At present, there is no local domicile of choice in South America.

"When the Bermuda conference was on, they specifically geared it towards Latin America so risk managers and organisations in LatAm are seeing Bermuda as a home for captives because of its reputation and history – and also logistically it is closer," says James. "Bermuda would be the place they would head to by default."

Bermuda has set up tax information exchange agreements (TIEAs) with a number of Latin American countries and this has helped it win a number of new formations, according to Shelby Weldon, director of licensing and authorisation at the Bermuda Monetary Authority.

"The Bermuda market has spent some time in Latin America talking about Bermuda as a viable captive domicile and we have seen some formations.

"I would suspect that when multinationals in Latin America look at jurisdictions to set up captives in, Bermuda will continue to be one of the first jurisdictions that come into their discussions," he continues. "I know Bermuda is not alone in seeking captive business from that market but we are well placed to take advantage of the growing economies in Latin America and the increased interest in captive solutions. I've had the opportunity to spend some time in Latin America and Bermuda has a very good reputation there."

'The Bermudas, Guernseys and Caymans of this world still have a part to play'
Clive James, Kane

» managers of these organisations to rethink what they are paying the premiums for.

"The decision to set up a captive all depends on the parent company," he continues. "The corporations within those [BRIC] economies are growing to such a size – they're getting more sophisticated with risk management because it is a bigger part of their cost equation and premium spend is a bigger part of their budget, so naturally that focuses the mind. Second, these corporations are becoming more regional as well as global, so they're crossing borders and having risk management issues that they perhaps wouldn't have locally.

"A captive in certain circumstances does provide a good solution for them and when they're perhaps using one global market, that does make a captive option quite opportunistic," he concludes. "In terms of sophistication, they're looking for alternative ways to perhaps access the reinsurance market so there are some financial structures out there that these economies are looking at."

The decision for a parent company based in an emerging market is where to locate its captive. Does it opt for an onshore local domicile that offers close proximity to the parent, a familiar regulatory and legal system and, of course, the same language? Or does it choose an established offshore captive domicile, with what is likely to be more favourable tax treatment, a long track record and credentials, more innovative regulation and a broader infrastructure to serve its captive needs?

Some regions aim to offer both, with Labuan an increasingly popular choice among Asian parents and currently ranking 25th by number of licences globally (its licences grew to 41 from 34 in 2012). It also has a strong reputation for takaful structures, which could prove attractive to parents based in Islamic countries.

"Labuan is growing, but politically there are issues in terms of certain countries going to Malaysia," says James. "Likewise with certain companies going to Singapore. Singapore is a sophisticated centre for captives but most of its market is still Australia and it doesn't have the cell legislation that Labuan has.

"The Bermudas, Guernseys and Caymans of this world still have a part to play," he continues. "A number of these companies or representatives will go to London anyway as a matter of course to access the reinsurance market, so somewhere near London often makes sense. The major domiciles will continue to take on most of the new business, as it doesn't matter where that business emanates from, and that will probably not change." **SR**

Corporate risk management in the Middle East – A regular topic at Multaqa Qatar

From 9-11 March 2014, more than 500 senior executives of the risk industry operating in the Middle East and Northern Africa (MENA) region will meet for the eighth Multaqa Qatar Conference in Doha. As in previous years, reinsurers, insurers and intermediaries will be joined by corporate risk managers to discuss key (re)insurance market developments from the asset owners' perspective. Multaqa Qatar will again feature a dedicated Risk Management Roundtable hosted by *StrategicRISK*.

Driven by a rapid growth of insurable assets, the MENA insurance sector has grown to more than $44bn (€32bn) in annual premiums, with more than one-third of premiums generated through the corporate sector. More than 150 companies in the Gulf Co-operation Council (GCC) countries generate annual revenues of at least $500m, according to MEED. In addition, infrastructure spending is booming. The total value of projects in the GCC countries being planned, or already under way, is about $2.5trn. Huge and complex projects call for more and more sophisticated insurance cover.

Another powerful structural driver of risk management in the region is the privatisation of previously owned state assets and roles. This trend generates additional demand for commercial insurance solutions and the specific risk management benefits offered by them.

At the same time, an increasing number of private-sector companies are setting up dedicated risk management functions to meet the requirements of modern corporate governance. This trend, as well, is poised to benefit commercial insurers operating in the MENA region.

Akshay Randeva, director strategic development, Qatar Financial Centre Authority

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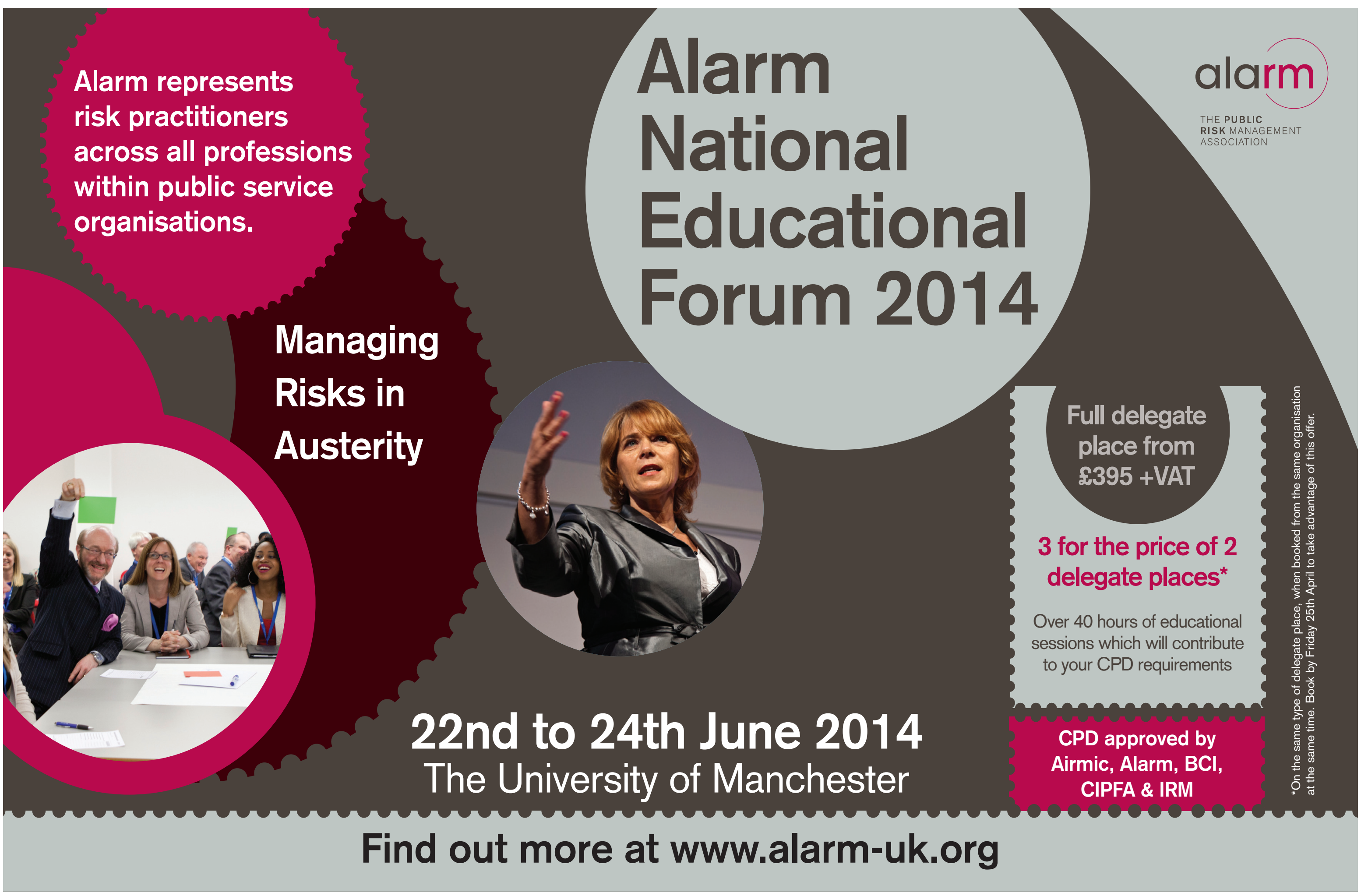
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SECTOR VIEW

BIOTECHNOLOGY

Risk under the microscope

Biotechnology is booming, yet the neglect of effective risk management could have disastrous consequences for the public and for the industry as a whole

BIOTECHNOLOGY IS BIG BUSINESS. A growing, ageing, global population is creating a demand for high-tech products, from genetically engineered crops to new drugs, to feed us and keep us healthy.

Analysts at international accounting firm EY estimate that global biotechnology industry revenues for publicly held companies were more than €66bn in 2012, up from €61bn in 2011 and €59bn in 2010.

Already a new generation of genetically engineered drugs is estimated to make up 10% of the global prescription drugs market – 20% in the US – and this will only grow as more drugs emerge and existing drugs drop in cost. The area planted with GM crops globally increased by a factor of 94 between 1996 and 2011.

But despite booming business, the industry is far from risk-free. Investment costs are sky-high, competition is fierce and there is danger of a catastrophic problem, whether in clinical trials (see box overleaf) or with PR – as with the introduction of 'Frankenstein food' GM crops in the UK, which triggered widespread protests.

Successfully risk-managing this process is "all about how you get from the lab to the high street", according to Christopher Bryce, leader of the Chemicals and Life Sciences Practice at Marsh. "The beginning and the middle is the most interesting bit. The end is usually taken care of through licensing deals and not that interesting in terms of risk management. What's actually happening in and out of the lab, the way you are interacting with patients in trials, that's the critical bit."

Risk neglect

Biotechnology is heavily reliant on innovative start-ups and this can result in a cavalier approach to risk in the early stages. "I'm not sure if it is that they are not fully attuned to the risks, or whether they are just hoping that it doesn't happen to them," says Bryce.

Neglecting risk management is extremely dangerous. For example, according to Bryce, the cost of getting a drug to market is estimated to be about $1bn to $2bn, up from $200m a few years ago. "The easy wins were back in the 1970s," he says. "Now it's much more difficult and takes longer to get them through the process. Regulators are demanding a lot more information about the effect of drugs because they are concerned about public health."

Given the scale of the investment, risk-managing the early stages of development is critical. Of particular importance is data security. The risk of a hacking attack is real (see box overleaf) and can be catastrophic for a young firm.

> *'I don't think in the biotech sector people have really caught up with the risk'*
>
> **Christopher Bryce,** Marsh

Some firms choose to transfer this risk to the market. "In Europe, buyers often think they are getting their cyber risk covered under their normal liabilities cover," says Bryce. "In the US, it's more typical to buy a specialist product.

"I don't think in the biotechnology sector people have really caught up with the risk. There have been examples of where data has been mismanaged and you have to get back to the trials, or you get out of step with the regulators and have to go back – which can have a real impact if you are competing to get a drug to market. Also, espionage cyber risk can cost them a huge amount."

But some in the industry feel that the risk goes beyond insurance and look to other solutions. "I have not found anyone who thinks separate [intellectual property] cover is a value proposal," says Claude Breutel, head of insurance at Syngenta. "The area is highly skilled, highly complex. For smaller companies, it may be a value proposition. But for the larger companies, you are talking about exposures far beyond the capacity available on the market.

"Cyber insurance is also a no-brainer for us. It is not a value proposition. The picture is diverse. We are exposed to various activist groups that wish to attack us or launch a cyber war against us, but we know about this and so we are prepared.

"In terms of data security, data integrity, risk management and technology are at such a high level that our security group does not think it is of value for us to look into financial cover. "We have identified our employees as the main exposure – how they are managing, transporting and handling critical information. We looked at this and felt that, ultimately, insurance is not the way for us to address this risk."

All agree the moment that a product interacts with the public, the stakes are raised in terms of risk – as are the demands on insurers. The regulatory framework is complex and evolving. No one can afford mistakes.

Added complications

"When you get into clinical trials you get added complications," says Bryce. "The whole issue of clinical trials is very interesting – the EU is about to change the way things are done" (see box overleaf).

Liabilities cover is a key issue. "So far, there haven't been many claims, but when they happen they tend to be high-profile, media events," says Bryce. "It's been a profitable area for the insurance industry. But it hasn't tackled the regional laws, and at the moment you are still subject to different rules in different countries; different attitudes to compensation."

As such, the onus is on risk managers to make sure their cover takes a multinational view. "Complex liabilities are something that occupy [firms looking at their exposures] more and more," says Breutel. "We have to abandon the idea that one size fits all. We cannot function with one standard liability package across whole industry sectors; this kind of thinking goes back to the 1980s and 1990s. Everything has developed since then – technology, regulations, everything.

"I am not sure whether this is reflected in the products available. Biotechnology in general is high-tech, and depending on where companies are located they may be directly consumer-facing and this can be a challenging place to be in terms of regulation and pressure from consumer groups."

Complex chains

As with all firms, supply chains are an issue for biotechnology. "One constant theme for us is always logistics and supply chain complexity, the vulnerability to contingent business interruption," says Breutel. "Specific to our company, over the past few years we have seen more and more extreme climate-related events. This continues to be an issue for our risk managers."

Biotechnology comes with its own specific supply chain issues. "There is a lot of pressure coming through from the regulators at European level for compliance within the supply chain and regulation of quality both in the end product and along the way," says Bryce. "They are starting to put pressure on drug manufacturers to warrant their products from cradle to grave within the supply chain.

"The further you get away from the developed world, the harder it is to find companies that will comply, and so you have a situation now where Indian companies are being battered by the regulator and excluded from the market.

"This is significant, because biotechnologies don't tend to make products themselves, they make them in the lab, get them through animal tests and then go to specialist companies to get this stuff made for human trials. It's obvious that you need good risk management. If you get a product made incorrectly, it can be a real problem."

Risk managers need to ensure that their firms maintain good practice in the distribution of products. "Particularly around the handling of temperature-sensitive goods there is increasing pressure for regulations and this is all bearing down on the industry," says Bryce.

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Expert insight: Risk in the life science sector

Life science companies continue to face challenges on all fronts and risk managers continue to ask themselves questions about how they can use their risk-financing tools to address a storm of environmental factors.

Compliance remains a huge issue. The sector is one of the most heavily regulated industries in the world; rules develop fast and the operating environment differs across markets.

Many firms continue to face loss of patent protection – and an associated collapse in revenues – while there remains a lack of new products to replace them. There also continues to be a lot of pressure on cost.

As companies respond to this, they often increase outsourcing and open up to partnerships with firms that might have been competitors a few years ago. Similarly, some life science companies are embracing generics, devices and innovative medicines in their portfolio. New risks emerge.

For risk managers, it's complicated. When you sit down and look at a list of your company's top risks you may come to the conclusion that most are commercial and either non-insurable or difficult to obtain the correct cover for. Having said that, insurance can remain an incredibly important tool.

Ask yourself: what is my strategy? Can I retain these risks? What about alternatives? Many firms are turning to a centralised view of risk, perhaps formalising through a captive. A captive can allow 'risk bundling' and, through partnering with insurance companies, you can take a long-term view and minimise the amount of annual cover you buy. It can also help 'incubate' traditionally difficult types of cover or non-insurable risks. It can even help move away from an annual buying process. This is setting a medium- to long-term risk strategy, not reacting to the vagaries of the insurance market when a type of cover is not available or too expensive.

If you decide to use a captive as a centrepiece for risk retention then ask: where should the captive be held? How can I use it most efficiently? What risks do I put into it? Do I reinsure behind the scenes? How do I best structure the reinsurance? What traditional insurance might I need to complement it, such as annual cover for less frequent but costly events? Should I buy catastrophe cover or is it a risk financed by other means?

When looking at cover, the better you are able to identify and quantify your risk, the better the cover you will be able to get. If you can put in place a process to identify exposures and put a dollar value against them, then the more confident insurer will be able to allocate the right capacity at the right price. This is clearly true in terms of supply chain risk. Increasing regulatory intervention is making 'non-damage' cover more and more important in the insurance manager's toolbox. Again, if you can identify your pinch points, the better you will be able to negotiate and put 'fit for purpose' programmes in place.

Insurance can be a valuable risk-financing tool. It is also required for compliance purposes or to enable a business to operate in a practical sense. In the race to get a product to market you need to know that you have insurance in place – delays are unacceptable. Clinical trial insurance is an excellent example. Working with insurance partners that will grow with you is also important.

If you are entering new territories or diversifying into new products, are the trials covered? Are all the local compulsory covers in place? Do you need a local insurer and broker? If the regulatory environment changes, are there processes you can streamline to make sure you get cover on time?

Ask yourself – and your broker – some tough questions, and be prepared.

James Bird, partner, JLT Life Science and Chemical Industry Practice

> *'Biotechnologies don't tend to make products themselves, they make them in the lab, get them through animal tests and then go to specialist companies to get this stuff made for human trials. It's obvious that you need good risk management'*
> **Christopher Bryce**, Marsh

» Supply chains with multiple stakeholders also demand effective risk management of relationships between stakeholders. For example, in drug manufacture you might have the developer, a contract research organisation that manages the trial and then potentially the licensee, which will distribute and supply the product. "If these relationships break down, the scope for litigation is huge," says Bryce. "There is a tight window for getting your product from A to B to C. The first to market tends to scoop the prize, and if you get off schedule, that can be a problem. You may not even have the best product, but if you are the first to market, you win.

"It's all becoming a bit more complex and a bit more frantic. It's all getting much more sophisticated. You can't just go to any company and ask them to make a DNA or personalised medicine. There are only a handful of companies that do can that, so your ability to go somewhere else if a problem arises is limited."

In a rapidly changing environment, risk managers need to keep their eyes wide open to risk – and ask themselves tough questions about whether their insurance is up to the job. **SR**

Malicious mail

Just how vulnerable your firm's intellectual property is, and the effect a hack can have, are well illustrated by the unfortunate case of a world-leading biotechnology company engaged in developing the next generation of pharmaceuticals.

The company was just ready for a product launch following five years of research and development representing a £1bn (€1.2bn) investment when it was hacked, according to research by CESG, the information security arm of UK agency GCHQ.

A "sophisticated and targeted cyber attack" allowed hackers to steal the details of its research.

The method was simple enough. Eight months before the product launch, the research director received an email that appeared to be from a colleague, with a PDF of a relevant scientific paper attached. The email was actually a fake and the PDF attachment contained malware that exploited a software vulnerability for which the patch – already available for months – had not been applied.

This textbook attack allowed the hacker to steal the research and other sensitive information, in turn enabling a foreign competitor to release a cheaper version of the product to market way ahead of the UK company.

According to CESG the company was not only affected by major material financial loss, but also damage to its reputation, which made it harder to secure investment for future products, and the loss of contracts to the foreign firms that beat it to market.

Clearly, this is a loss that was beyond anything that insurers can cover in terms of risk transfer, and risk managers need to look to other forms of defence.

CESG argues that the attack could have been prevented with a tighter information risk management regime, better security controls, better education of staff on cyber risks, better internal monitoring of data and better protection against malware.

Regulatory warning

Big changes are being proposed to the regulatory framework covering clinical trials in Europe of which all risk managers buying insurance for medical biotechnology need to be aware.

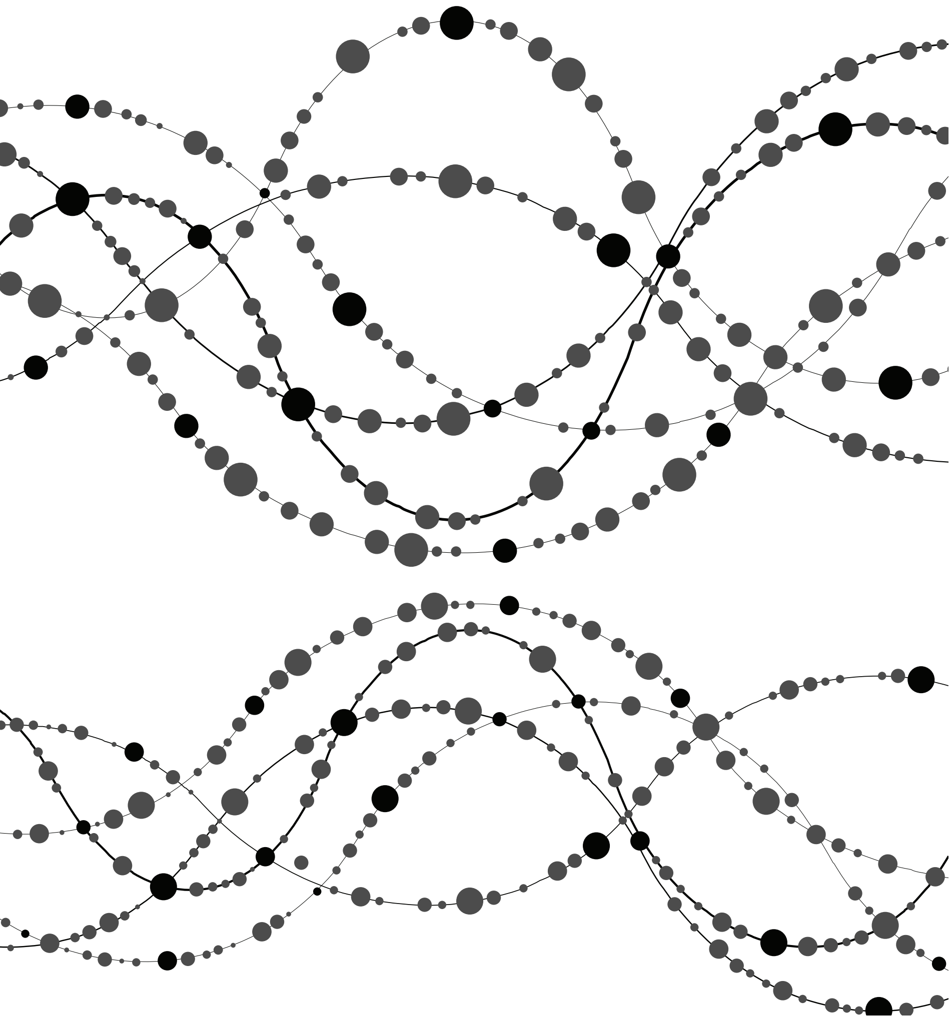
"This overhaul of the EU Clinical Trials Directive 2001/20/EC is big news, and so far it is really slipping under the radar of the insurance industry," says Bryce. "It will have big implications for the management of risk. It will require more data to be shared. It will require you to have national indemnification in place."

In 2012, the consultation process on the directive identified several changes to the regime that could affect the insurance and risk management of clinical trials in the EU. A draft report published by the European Parliament in May 2013 identified a number of amendments that could have implications for insurance and risk management. This included changes in indemnification and compensation for volunteers in clinical trials, as well as sponsor responsibility and how this responsibility is allocated within sponsor teams and member states.

According to research by Marsh, the major messages for risk managers are:

- No requirement for specific insurance or indemnification in respect of low-intervention clinical trials;
- Introduction of a national indemnification mechanism, which works on a not-for-profit basis;
- European Commission considers that national indemnification mechanism will benefit "non-commercial sponsors";
- The proposal will be enacted as a regulation, replacing the current directive and will thus achieve consistency across all 27 member states.

"No one wants to pick a fight with Brussels over this, but it will become a big issue in 2014," says Bryce. "It effectively requires, on the face of it, the UK government to underwrite trails in the UK."



Trials disaster

Risk management is a serious business in biotechnology. But unfortunately, sometimes, there is only so much that you can do to prevent a disaster.

Just how badly wrong the late stages of drug development can go is amply illustrated in the 2006 first phase of human testing of the anti-inflammatory drug TGN1412.

Within minutes of being administered to six volunteers in a London hospital, the men suffered multiple organ failure.

Another volunteer, Raste Khan, who had been given a placebo, described how the room turned into a "vomiting bath". "People were fainting and coming back to consciousness," he said.

Although the men survived, they may never fully recover and could suffer lifelong damage to their immune system and a higher incidence of cancer and other illnesses.

Subsequent investigations found that all protocols have been followed correctly in the trials, and the adverse reaction was not due to contamination, or incorrect dose, but unforseen effects of the drug.

The firm that developed TGN1412, TeGenero Immuno Theraputics, entered insolvency proceedings in 2006.

Expert insight: Where to focus in 2014

What is so special about risk management in the biotechnology and life sciences sector?

Quite simply, while the sector may share some characteristics with other businesses and industries, it also has a unique group of characteristics that includes a long gestation period of new products, a long product life and a long tail of liability.

In common with most businesses, relatively few of the key risks are insurable.

In particular, these industries operate in an environment where the consumer will ingest the product into their body, providing a real personal risk/reward situation for the user. There is always a risk when taking the product, with potential side effects.

A successful product in this industry starts in a pipeline of hundreds of ideas and developments, of which the majority are scrapped or shelved during the development. The rigorous regime of testing and regulatory control adds huge costs and lead time, exposing the intellectual property to theft or espionage.

Maintaining quality and regulatory compliance are key to exploiting its commercial value. Competing in a market where a competitor may take the market with a cheaper or more effective product threatens the return on the investment. In some countries where bribery and corruption are part of the business culture, it is hard to compete on a level playing field.

Once the product is in the market, a new set of risks appear. Supply chain and materials integrity, foreign exchange, cashflow and credit risk – together with the long-term effects of the product on users – create additional exposures. This is especially true for product issues that result in class actions in litigious countries.

Lastly, biotechnology and life sciences are emotive subjects for many people. Pressure groups, using media channels, can attack and damage the reputation of the best companies and their products.

So, where should the risk manager focus in 2014? While the market is still soft and new capacity is available, broadening coverage, reducing deductibles and self-insurance may increase the ratio of coverage to unit cost.

This is a tried and tested route. Perhaps it is time for a change.

Consider these questions as part of your insurance strategy for 2014:

- Is the insurance programme aligned with the key business risks and the acceptable levels of risk?
- What appetite is there for assuming risk?
- Does the insurance programme align with it?
- Are there new areas of risk that could benefit from risk financing or transfer as a mitigation tool?
- Are there areas of insurance coverage that have limited value or are below the group risk appetites?
- Is there a need to spread risk to support smaller business units in the group?

Paul Taylor, independent risk consultant and former Ferma board member

A BITTER PILL FOR GLOBAL BRANDS

Dawn raids have proved the anti-cartel authorities in China mean business when cracking down on international firms

SOME OF THE WORLD'S BIGGEST brands are preparing their staff for dawn raids by China's anti-monopoly agencies in the wake of hostile legal decisions against long-standing distribution agreements. The latest victim is US pharmaceutical company Johnson & Johnson, whose contract with a distributor had remained unchallenged for 15 years (see box).

Companies found in breach of relatively recent official policies on retail price maintenance deals have been given hefty fines of up to 6% of annual revenues in China, with serious offences attracting fines of as much as 10% of revenues in China.

In a widespread campaign, the authorities have so far taken action against the pricing of everything from infant milk powder to scallops to jewellery, and, in Johnson & Johnson's case, bandages and sutures. Simultaneously, the authorities are also investigating pricing by 60 pharmaceutical companies, including some foreign firms. With potentially enormous implications, they are also reportedly collecting data on the pricing of all foreign cars.

Resale price maintenance (RPM) arrangements are a particular concern, setting out important lessons for international companies. As law firm Jones Day warned late last year: "The lesson is that companies should steer clear of RPM requirements when dealing with distributors in China."

Moreover, the authorities aren't just picking on international brands. Their actions form part of a general campaign against allegedly anti-competitive arrangements.

Tough penalties

Two big Chinese liquor manufacturers were given penalties of $71m (€52.2m) over their minimum resale price arrangements with distributors. Although the fines were equivalent to 1% of annual revenues in China – the lowest that could be charged – they were the largest anti-trust penalties imposed in China.

But this particular authority – the National Development and Reform Commission (NDRC), one of four anti-trust agencies – was just warming up. In August, the NDRC imposed penalties of $107m (€79m) against a group of producers of infant formula. It took issue with arrangements with suppliers that allowed the manufacturers to maintain high prices that, the agency claimed, reduced competition to the detriment of consumers.

The conclusion from all this activity is obvious. "In light of the recent series of investigations and new record fines for RPM practices," warns law firm Mayer Brown, "clients should be mindful of the focus of multinationals and be on the alert for any pricing practices that could raise anti-monopoly issues".

Rewards of co-operation

But how should an investigation be handled? As lawyers point out, co-operation with the authorities is vital, even though companies may feel aggrieved at the abrupt change in attitude towards what may have been long-standing commercial practice.

The benefits of co-operation became clear in the infant formula case, when three of the nine manufacturers in the sights of the NDRC volunteered the details of their RPM contracts, provided important evidence and hurriedly rewrote the contracts. The three were handsomely rewarded for their good behaviour by escaping any monetary penalty, while the other six suppliers under investigation were fined between 3% and 6% of their most recent annual revenues in China.

The looming threat of hefty penalties has prompted companies to rescind their contracts with distributors and start again. "While formally subject to analysis by rule of reason, RPM obligations are unlikely to be found compatible with anti-monopoly laws," points out Peter Wang of Jones Day.

In the meantime, companies should be prepared when the enforcement authorities come knocking. The best rule of thumb appears to be: keep calm and comply.

Mayer Brown states: "In light of the increasing enforcement activities of the [authorities] in relation to anti-monopoly conduct rules – such as those dealing with cartels, vertical agreements and abuse of dominant market position – business must be ready and prepared to deal with an investigation in a way that best protects the interests of the company." That means

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making planning and training a priority for any business with substantial operations in China.

Boardrooms must also be aware that a raid may come at any time unannounced – officials have the power to conduct onsite investigations without notice.

Mayer Brown's Hannah Ha believes a well-prepared company can avoid the worst. "How an investigation is handled can make all the difference to a business's prospects of being found to have infringed anti-monopoly laws and whether leniency is granted," she says. She recommends frontline staff – receptionists, legal advisers and designated response teams such as risk managers – should be given advanced training.

Designated staff should be trained to react immediately. At least three people are required: one to create a written record of everything, including staff who have been interrogated and documents that have been inspected; one to assist the officials; and another – ideally a lawyer – to take charge of any additional liaison with the officials.

Although the protocol for a raid is important, the main principle should be one of co-operation. "Do not appear unhelpful or obstructive," emphasises Ha. Most important of all, do not impede an investigation, either by failing to provide information or by destroying evidence.

Further, the moment the door has closed behind the officials, companies need to activate a follow-up strategy, including calling in expert advice where necessary.

Veterans of such raids say a comprehensive risk-assessment procedure should follow any onsite investigation. If the review reveals that conduct falls short of the prevailing standards, prompt remedial action will minimise the penalties and the impact on reputation. Every step of the repair work should be done in close consultation with legal advisers and duly recorded.

When the officials come back, as they probably will, they will expect to see full details of the remedial process. **SR**

'How an investigation is handled can make all the difference to a business's prospects of being found to have infringed anti-monopoly laws'

Hannah Ha, Mayer Brown

Johnson & Johnson taken by surprise

It was the decision against Johnson & Johnson that, more than any other, rammed home the turnaround in China's approach to anti-trust issues and spurred international firms into action.

The case started over a dispute with the pharmaceutical company's long-time distributor, which took upon itself to sell suture products below the minimum resale price defined in the agreement. The distributor wanted to expand into another market, but an aggrieved Johnson & Johnson rescinded the deal.

In response, the distributor took the American giant to court on the grounds that the resale price maintenance (RPM) policy to which it had long complied violated anti-monopoly laws.

Johnson & Johnson won the first round but lost on appeal, when the Shanghai Higher Court concluded that the RPM clause was in fact illegal.

Although Johnson & Johnson argued that the arrangement was pro-competitive because, among other things, it helped ensure reasonable profits to the distributor, the court disagreed on this and with almost every other argument the company advanced.

The upshot is that many global brands are rewriting historic pricing arrangements and that RPM deals may be off the agenda completely. As Peter Wang of Jones Day warns: "The safest approach is for companies to avoid RPM requirements when dealing with distributors in China."

A SPECIAL PLAYER

The employment contract of in-house lawyers must reflect the special relationship they have within the company and the legal world

THERE ARE A NUMBER OF RISK management strategies drawn from global case law and experiences applied by businesses regarding the framework and management of in-house legal teams (see *StrategicRISK*, December 2013, pp42-43).

One strategy concerns the terms of an in-house lawyer's employment contract. Such a contract is one of the fundamental building blocks that should underpin a business's risk strategy and it therefore requires appropriate and measured consideration when putting together any in-house legal operation.

As with many risk management strategies, global case law tends to dictate the terms that should, as a matter of best practice, be incorporated into an in-house lawyer's employment contract. Courts worldwide are delivering a message to businesses that they expect to be provided with evidence that the employment relationship between a lawyer, as employee, and their employer is not undermining the lawyer/client relationship.

In-house lawyers are distinct, given that, unlike other employees, they hold professional obligations and duties to their client, the administration of justice and the court.

As such, standard terms of employment are not sufficient, and the unique aspects of a lawyer's place within the wider and legal communities need to reflect this.

Businesses in the US have a long-established practice of incorporating specific terms into an in-house lawyer's contract of employment. This is not surprising, given that US in-house lawyers have historically played – and continue to play – central roles within organisations.

The remainder of the global business and in-house legal communities have not necessarily reached the same point, but it is essential for any organisations employing in-house lawyers to have a comprehensive understanding of the issues.

Acting for a client

Lawyers are engaged to "act for" a person(s) or organisation(s). This is fundamental to the professional lawyer/client relationship, and the employment relationship does not alter that basic principle. Although, on the surface, this may seem insignificant, a term that states an in-house lawyer is employed to "act for" a particular organisation or organisations (as in the case of corporate groups) demonstrates, at least on the face of it, that the business appears to understand the unique relationship it holds with its in-house lawyer(s).

Independence

Whether it is the courts throughout the UK, Europe (most notably, the 2013 decisions in Belgium and the Netherlands), Australia, Hong Kong, the US or Canada, the same point is reiterated throughout and is abundantly clear: the independence and ability to demonstrate such independence of any in-house legal team are non-negotiable.

As mentioned in December 2013's *StrategicRISK* article, the independence of an in-house legal team is paramount and several risk minimisation strategies can be adopted relating to the operational framework to ensure that independence is not undermined.

This issue has the potential to become significant to any business that does not appropriately address and deal with the independence of its in-house legal team.

Ensuring the structural integrity of the in-house legal operation also needs to be supported by a further risk strategy, and part of that requires appropriate documentation to be in place concerning an in-house lawyer's employment relationship with their employer. As such, fundamental independence clauses in the employment contract should be in place:

- Employer recognising independence: showing that an in-house lawyer understands the independence concept is only part of the picture. The employment contract needs to stipulate that any in-house lawyer is employed to provide independent legal advice to the business. But it should go further. Arguably, it is also an obligation to be placed on the employer. Accordingly, the contract should identify that the business recognises its internal legal advice must be independent and that the business will not prevent or hinder its internal legal operation from maintaining that independence.
- Ethical duties: by and large, the business community understands that onerous ethical duties are placed on lawyers. Those duties do not merely vanish or diminish because a lawyer has taken their career in-house. The employment contract therefore needs to give some credence to this. The practical effect of that credence is that a clause(s) is required that clearly states that the contracting parties agree that an in-house lawyer's duties are:
    - not only to the employer as 'client' but also to the court and to the administration of justice; and
    - in the event that those respective duties come into conflict, the duty to the court and the administration of justice will take precedence.

  In conjunction with that, in circumstances where an organisation employs a senior lawyer – usually a general counsel, but not always – it would be appropriate for the employment contract to include a clause that provides that, as the organisation's most senior in-house lawyer, they may go above their reporting lines and bring matters to the attention of the board if such action is warranted in their professional opinion.
- Admission to the bar, practising certificates and professional bodies: it may, on the face of it, seem an obvious inclusion, but clauses requiring an in-house lawyer to be admitted to they local bar, to hold a practising certificate and to be a member of their professional body do not appear as commonly as they should. Again, such clauses are fundamental to any sensible employment contract and demonstrate that employer and employee have reached a common understanding as to the importance of the independent legal advice.

The independence of an in-house legal team is paramount and several risk minimisation strategies can be adopted

Restrictive covenants

Likewise, incorporating a restrictive covenant into an in-house lawyer's employment contract is not a clause commonly seen. Its importance becomes clear in a scenario where an in-house lawyer moves organisations and receives instructions from their new employer to sue their former employer. An in-house lawyer can acquire very intimate knowledge of, or from, the client – an organisation's general attitude to the litigation process, for example, or how individual employees react under cross-examination. An organisation would be quick to react should it find itself in such an unpalatable position.

A body of case law – mainly from the UK and Hong Kong – is starting to develop around this topic. To date, courts have taken a liberal view on the issue and have not imposed onerous restrictions on in-house lawyers who may find themselves in such a position. In that regard, if an employer wants to restrict an in-house lawyer's post-employment and prevent them from acting against it, the courts have required that an in-house lawyer's employment contract contain an enforceable restrictive covenant along those lines. As such, an organisation needs to ensure that it has an appropriate risk strategy in place as part of an in-house lawyer's employment contract to deal with such an issue.

Minimising risk

The internal legal operation within a business plays a vital role in providing positive long- and short-term benefits to that organisation. However, without an appropriate framework around the employment relationship between a business (employer) and its in-house legal advisers (employees), an organisation leaves itself potentially vulnerable on several fronts. Incorporating appropriate clauses into a lawyer's employment contract is relatively straightforward – but an effective way of minimising business, commercial and legal risk. Equally, as a risk minimisation strategy, this should not carry any significant cost burden. **SR**

Sascha Hindmarch is of counsel in the London office of US/UK litigation boutique Hausfeld & Co

Top tips

As part of the risk management strategy regarding an in-house legal operation, best practice dictates that the terms of employment must reflect the unique place a lawyer has within the wider and legal community, and be robust enough to withstand scrutiny from a court.

Beyond the standard terms contained in most employment contracts, an in-house lawyer's employment contract should contain additional terms, being:

1 They are employed to "act for" the business.

2 A reflection of the 'independence' of the in-house lawyer and their legal advice.

3 A reflection that an in-house lawyer's ethical duties to the court and administration of justice prevail over their duty to the business, should the two come into conflict.

4 An organisation's most senior in-house lawyer will raise matters at board level if the need arises.

5 Recognition that an in-house lawyer should be admitted to practise, maintain a practising certificate and be a member of their professional body.

6 An enforceable restrictive covenant to prevent an in-house lawyer from acting against their employer post-employment.

Calm waters of the Guernsey scene

The Channel island continues to lead the way with captives, protected cell companies and insurance-linked securities, while offering certainty against the prevailing Solvency II regime

GUERNSEY

Vital statistics

European captive ranking	1
World captive ranking	4
International insurance entities	758
Licensed managers	20
Captives from FTSE 100	40%
Captives from Global 1500	95
Innovation	PCC, 1997
Tax regime	0%
EU member	No
Regulator	GFSC

Data Source: Guernsey Finance

INNOVATION AND A FIRM STANCE ON Solvency II has allowed Guernsey to thrive at a time when rates in the commercial insurance market are "super soft".

However, undoubtedly, plenty of challenges face the insurance and captive insurance market. Commercial insurance and reinsurance prices remain low following a continued influx of capital market capacity and a year that was free of major catastrophe losses.

"Rates are quite soft and yet there's an awful lot of capacity being attracted into the insurance market," says Dominic Wheatley, managing director of Willis Management (Guernsey).

"If you think about those two ideas in tandem, you realise it's a slightly bizarre world we live in –unless you take the view, as I do, that rates may be soft by reference to historic norms, but not as soft as they have been in the past in relation to returns of capital achieved in the insurance industry."

Despite the soft (re)insurance market, Guernsey continued to grow in 2013. The Guernsey Financial Services Commission (GFSC) licensed 89 new international insurers, bringing the total to 758 at the end of the year. This maintains its position as the largest captive domicile in Europe and the fourth largest in the world.

For major corporates, it is clearly a buyer's market in mainstream insurance and the impetus to self-insure is arguably less pronounced. So where is the growth coming from?

With the insurance cycle inextricably linked to captive growth, captive managers have had to innovate and seek new opportunities to grow their business. A quick look at Guernsey's licence statistics reveals a number of new trends, with much of the growth relating to cell companies and increasing use of insurance-linked securities (ILS).

"I wouldn't say that necessarily the mix of business coming into the island is in line with the traditional mix of business – or is indeed conventionally captives in the sense of being risk-financing vehicles for corporate entities," says Wheatley. "It's more niche, using insurance technology to bring risk and capital together but not necessarily in the corporate risk-financing context."

While maintaining its dominant position within the captive sector, Guernsey has built on its existing infrastructure to offer a broader gamut of insurance and financial solutions.

A big part of this is an increase in the use of cells – a Guernsey innovation, with the first protected cell company (PCC) set up in the domicile in 1997. There are now 69 PCCs and seven incorporated cell companies (ICCs), which are used for risk financing, to conclude International Swaps and Derivatives Association (ISDA) arrangements and fully collateralised ILS transactions.

"Guernsey is bucking the trend in terms of its growth, and I think that is attributable to the innovation in our business," says Paul Eaton, director of new business at Heritage Insurance Management. "For example, an area of significant growth is cells being used to facilitate fully collateralised reinsurance structures.

"We're also seeing the captive market continue making inroads to employee benefits lines. That whole area, including pension fund longevity risk, is really starting to generate significant interest."

The UK government chose Guernsey to set up a PCC as part of its NewBuy scheme in 2012. The scheme was launched in conjunction with the Home Builders Federation (HBF) and the Council of Mortgage Lenders to offer prospective home owners newly built properties with 95% mortgages underwritten by the UK government. The PCC provides insurance to the lenders under NewBuy, as well as being the conduit for the guarantee from the UK government. It has 50 regulated cells, including several multi-user cells.

Affordability issues

Cells also offer a good solution for sectors that are experiencing difficulty in accessing affordable insurance. "A classic use for captives is helping lawyers' with their professional indemnity insurance, when the commercial insurance market hardens or loses capacity," says Eaton. "The last renewal season was difficult and it's been well reported that a large number of companies have had to stop trading or be acquired, as a result of being unable to find the necessary PI insurance.

"Heritage recently had a number of enquiries from law firms that had experienced large rate increases and the application of substantial deductibles to their policies. This led many of them to seek a captive structure that could accommodate their retained risk," he adds. "This is a good example of a situation that can cause a medium-sized company to look for a cell company solution."

One of the biggest benefits offered by cell companies is that they lower barriers to entry. "If you look back 20 years, the captives were really the preserve of the FTSE 100s," says Fiona Le Poidevin, chief executive of Guernsey Finance. "Guernsey has about a 40% market share of all the FTSE 100s that have captives, but now, with the cell company concept, SMEs can benefit from the captive model by taking a cell of a PCC.

"That's why they've become so much more popular – they are cost efficient and administration is efficient. It also reflects the sophistication of the captive managers who are able to service different types of clients and types of risk."

Competitive edge

Much of the recent innovation in cell companies and ILS structures has been necessary, explains Wheatley. "New entrants to the industry have emerged in the past two to three years. The competition does inspire people to go out and look for business. There is a real competitive element to the industry here that is very positive.

"Guernsey has a pretty mature industry and has critical mass with well-established expertise, particularly in the cell area. The technical development and innovation around cell structures has always been very strong here.

"There's a real offshore insurance community, which helps in the innovation process. There's a movement of people between companies and that leads to a sharing of technology and so on. It all helps Guernsey plc to grow and attract business."

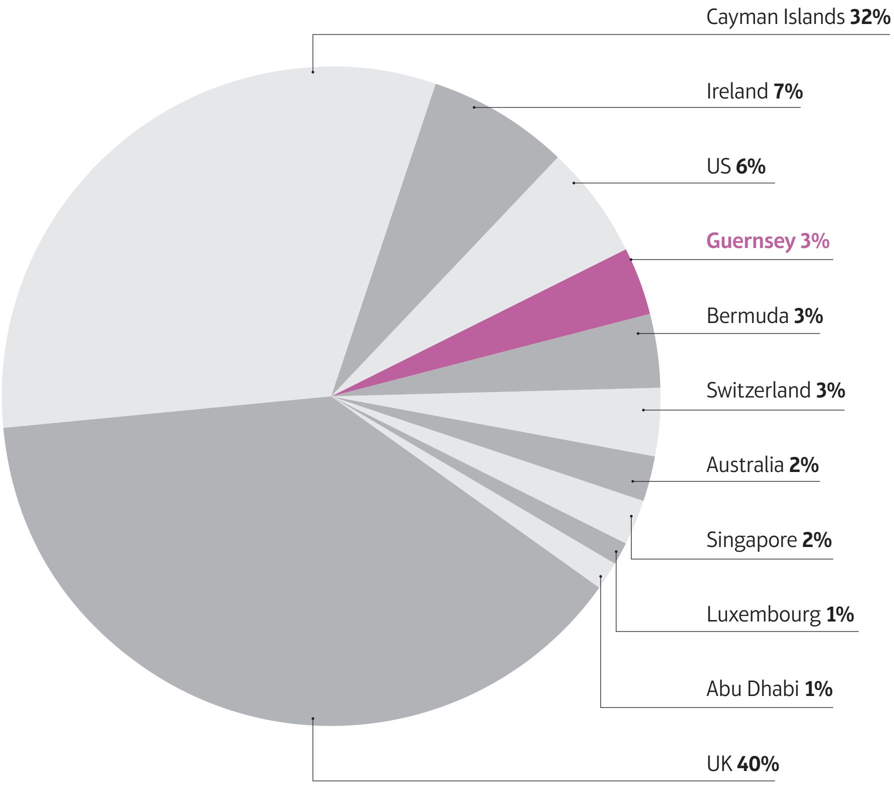
The dramatic growth of the ILS market has provided plenty of opportunities for captive managers. Guernsey has been quick to develop a reputation for its special-purpose insurers, cat bonds and transformer structures. In January, Guernsey law firm Bedell Cristin was recognised for an Islamic finance deal placed on behalf of European insurance group FWU.

"A lot of the growth we've seen in the insurance industry over the past year has been in ILS, so it's been quite good to see us diversifying," says Le Poidevin. "At the end of 2012, ILS investment fund DCG Iris was listed on the London Stock Exchange and it has been very successful to date.

"We have formed a group with representatives from both the funds and insurance industry, so we're better able to promote our services in that area. Not only are we able to create the insurance structures but we're also able to set up funds and to

Image courtesy of VisitGuernsey

New insurance licences by parent location, 2013



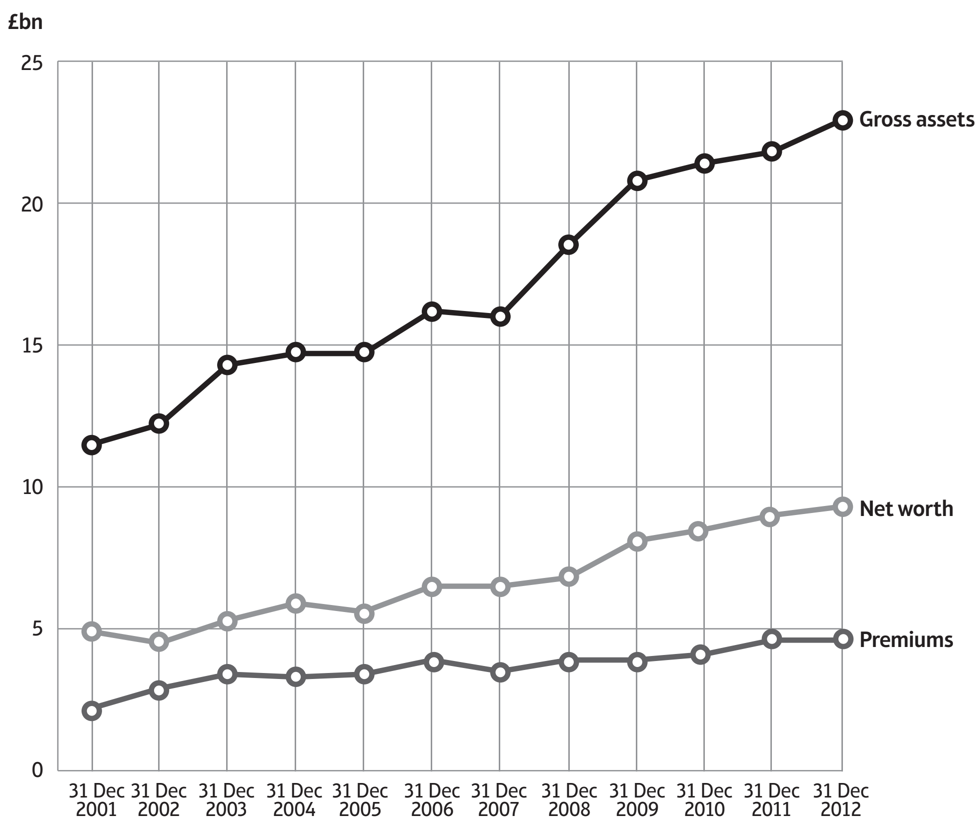
Data source: Guernsey Financial Services Commission

Numbers of international insurers

Type	31 Dec 12	Additions	Surrenders	Net change	31 Dec 13
Companies	242	10	10	0	242
PCCs	68	6	5	1	69
PCC cells	404	63	53	10	414
ICCs	5	2	0	2	7
ICC cells	18	8	0	8	26
Totals	737	89	68	21	758

Data source: Guernsey Financial Services Commission

Gross assets, net worth and premiums written



Data source: Guernsey Financial Services Commission

carry out the listings work. Indeed, Guernsey has more entities listed on the London markets than any other non-UK jurisdiction."

The capital markets – increasingly pension funds and institutional investors – are showing increasing comfort in investing in insurance products such as industry loss warranties, catastrophe bonds and collateralised reinsurance entities. The yield on offer in the low interest rate environment has captured their interest and the fact that insurance risk is largely uncorrelated to other markets is also attractive.

While up to 75% of ILS capacity is currently focused on US catastrophe risks, this is expected to change in the future as the sector expands and develops. As London and Zurich grow their importance as ILS centres, Guernsey should benefit further, Le Poidevin believes.

"There are a few key players here in the market, but we also have several lawyers who are well versed in ILS now. There have been some prominent listings on the Channel Islands Securities Exchange based in Guernsey, so we can offer quite an efficient route to market," she says.

"Guernsey also has the highest number of listings on the London Stock Exchange outside the UK. At the same time, Guernsey has an incredibly successful investment funds industry, so we're able to marry up the insurance experts with the fund managers and fund administrators and it makes a lot of sense to do that."

"No" to Solvency II

Another factor that has boosted business is the decision not to seek equivalence with Solvency II. At a time when rival domiciles are getting ready to implement Europe's new regulatory regime for the insurance sector, Guernsey announced in 2011 that it would not be going down that route.

And, as Le Poidevin explains, that decision has offered certainty to the domicile's international client base. "Some of the growth we've seen in the captive sector over the past couple of years has probably come from the decision we made about Solvency II," she says. "We've seen quite a few migrations recently from Bermuda because we've been able to give that certainty.

"Guernsey is not in the EU, so we chose not to participate in the Directive or seek equivalence as a third country. Solvency II was set up to protect third-party policyholders and it just doesn't suit the captive model at all."

Under Solvency II's "narrow definition" of captives, 80% of European captive insurers would fail to benefit from proportional treatment under the new regime, warns ECIROA (the European Captive Insurance and Reinsurance Owners' Association). In a letter to the European Commission, the association refers to a "number of outstanding issues that we look forward to resolving with the Commission and EIOPA".

"Without doubt, the current business mix in Guernsey would not be sustained were Solvency II equivalence to be pursued," says Wheatley. "The regime will be quite onerous for certain types of captive vehicle and create a fairly hostile environment. Not because Solvency II is fundamentally unreasonable in the context of mainstream insurance, but because in the context of the relatively small niche of insurance structures we specialise in in Guernsey, Solvency II would be an inappropriate regime and one that would be difficult to sustain on an economic basis."

Regulatory burden

He continues: "It does place a significant regulatory burden on captives potentially and I would think that does actually present a little bit more of a barrier to growth.

"On the other hand, Willis is still working with people to set up captive vehicles in Europe and for companies for whom Europe is their dominant theatre of operation. If they've got scale and a sophisticated approach to risk management and risk financing, then captives can still work and do still work in a Solvency II environment."

The biggest concern for European captive owners is the capital requirements under Solvency II. Those that fall within the scope of the regulation and do not qualify for proportional treatment (eight out of 10, according to ECIROA) will be subject to significantly higher solvency requirements than now. Monoline captives are particularly likely to see their capital burden increase substantially.

"I've had a lot of feedback from clients thanking us for not going down the Solvency II equivalence route," says Martin Le Pelley, compliance director at Heritage Insurance Management. "In Guernsey, we are developing a risk-based regulatory regime that will be calibrated to a 90% confidence level rather than 99.5%, which is what Solvency II requires, because 90% is deemed to be an appropriate level for captive insurance. This means the solvency requirements will be comparatively lower than would be the case in Europe and captive owners will continue to take advantage of an appropriate capitalisation of their captive.

"We're hopeful that people are going to start making some strategic decisions. We're already seeing strategic decisions being made because of the fact that Guernsey is taking a different stance with regard to risk-based regulation. We're seeing decisions being made to set up captives in Guernsey rather than the EU because the EU hasn't taken proper consideration of the impact of the Solvency II regime on captives." **SR**

Expert insight: Strategic thinking makes the difference for Guernsey

The news that Guernsey licensed 89 new international insurers in 2013 is exciting not merely because it reinforces Guernsey's position as Europe's leading offshore insurance centre but because the growth has taken place when the insurance market is described as "super-soft".

In theory, the sector shouldn't grow when market rates are soft because lower insurance premiums can mean companies have less need to insure themselves in captives and cell companies. It's no wonder then that the chief minister of Guernsey described the island's insurance industry as "the beautiful sector". Guernsey was also named European Captive Domicile of the Year at the UK Captive Services Awards 2013.

A significant proportion of the licences issued in 2013 were associated with structures related to insurance linked securities (ILS), whereas similar levels of growth in 2012 were fired by the UK government's NewBuy scheme and HBF PCC. Guernsey's insurance sector has diversified from being a centre for captive insurance into an international centre for both general and life insurance and reinsurance.

A fundamental shift is taking place in the insurance market with the emergence of ILS. Guernsey has positioned itself as an alternative to Bermuda. It has political and economic stability, no government borrowing and a regulatory regime that is at the forefront of international best practice – the implementation process of the IAIS Insurance Core Principles is reaching an advanced stage.

The groundwork for ILS was laid in Guernsey from 2005 and the number of transactions built year on year. The surge in deal flow in 2013 came about as convergence gathered momentum – the knowledge base already existed between the insurance managers, legal firms and the regulator, the Guernsey Financial Services Commission (GFSC).

It's been said that the hard part of being successful is staying successful; Guernsey stakeholders are aware of this. The Guernsey International Insurance Association established a Market Development Committee and an ILS sub-committee in 2013 to continue to develop Guernsey as an attractive environment for establishing international insurance entities.

Of particular importance is our regulatory regime, which continues to respond to innovative proposals. This was reinforced by the GFSC's decision to form an Innovation Unit.

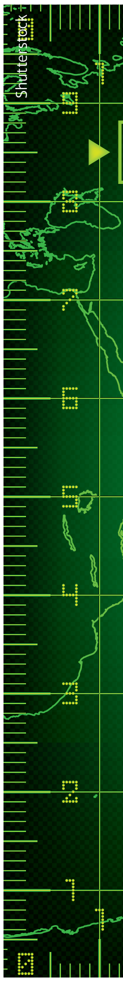
Aon was delighted to team with Bedell Cristin to deliver the sharia-compliant ILS structure, which was judged as the top innovative deal in Europe and one of the Islamic Finance Deals of the Year in 2013. We now have the opportunity to position Guernsey as a partner for more sharia-compliant structures.

Further evidence of strategic thinking bearing fruit is the decision taken in January 2011 not to seek equivalence with Solvency II. This now looks prescient in the light of the recent announcement from the European Captive Insurance and Reinsurance Owners' Association that as Solvency II stands "eight out of 10 European captives will fail to qualify for simplified solvency capital treatment in 2016". We have seen a number of Bermuda relocations already and Guernsey stands well positioned to provide the natural alternative jurisdiction for EU-based captives looking to escape the punitive effects of Solvency II.

Guernsey's solvency model will be IAIS-compliant and provide a proportionate confidence level for captives. Meanwhile, confidence levels in the Guernsey insurance industry are at an all-time high.

Paul Sykes, managing director, Aon Insurance Managers (Guernsey) Ltd and chairman of Guernsey International Insurance Association

FACEBOOK, FOREX AND FOREIGN EXPANSION ON THE RADAR



Social media slurs, volatility in world currencies and international partnerships are the major perils faced by big business in Australia

AUSTRALIA IS OFTEN SEEN as being at the forefront of risk management ideas and strategies. So when *StrategicRISK* met the cream of the continent's risk management community, local brokers and insurers recently, there was plenty to talk about. Two roundtable sessions – one in Melbourne, the other in Sydney – provided forums for discussion that ranged far and wide across Australia's risk landscape.

According to Aon's latest *Australasian Risk Survey*, small businesses rated their top five risks as cashflow; increased competition; reputational damage; regulatory or legislative pressures; and injury to staff and customers. Larger corporations ranked brand and image, the economy, the regulatory environment, business interruption and people as their top five.

The risk professionals who took part in the *StrategicRISK* roundtables work for some of the biggest organisations in Australia. Their top risks reflect Aon's findings, with economic conditions, retention and acquisition of talent, reputation risk and supply-chain disruption all ranking highly.

Regulatory pressures featured lower than expected on most firms' risk lists, but other concerns highlighted included credit risk and political uncertainty, refinancing, pricing volatility and execution of contracts.

Group manager of risk at diversified services company UGL Will Sare said contractual risk was critical to his company's operating model. "By understanding your contractual exposures, it allows you to take the right risks while avoiding the wrong ones and, as a result, minimising surprises," he said.

Service Stream head of treasury and risk management Mark Tomkinson said it was a challenge for any company to make money from its contracting.

"Success or failure is often heavily influenced by the degree of proactive risk management of issues before they blow up," he said. "Equally critical are the human behavioural factors of those involved in the initial bidding process and the ongoing running of the contracts, which comes largely from the prevailing cultural norms of the organisation."

Uncertainty about world affairs and the global slowdown has affected risk outlooks in Australia. Foreign exchange was a point of discussion, although most conceded little could be done about this. Tomkinson said the persistently strong Australian dollar continued to undermine the global competitiveness of Australian export industries.

"But there's little room for any domestic action to affect its strength," he added, "as conflicting strengths and weaknesses of the domestic economy limit the Reserve Bank of Australia's monetary policy options".

Talk turned to the ability of Australian businesses to remain competitive in an increasingly challenging global environment. Treasury Wine Estates' risk and assurance director Colin Knox pointed to Australian wine brands that faced "significant and increasing competition from overseas regions competing for the same shelf space in the same markets".

Most companies at the roundtables were targeting growth in global and emerging markets, many in Africa and Latin America. The nature of risks in those areas were said to be different from those in more traditional markets, with emergency response and crisis management coming to the fore.

Many questions were raised in this discussion. Should companies build their own distribution networks in massive markets such as China? Should they purchase foreign companies and face the practical and cultural difficulties this can entail? How does an Australian company go about imposing its own governance regime and cultural values on overseas partners so that it is understood that what might be appropriate in one market is not acceptable from a global corporate perspective?

Corporate knowledge

Sourcing experienced and reputable partners in other countries was difficult, the roundtable attendees were told. According to Sare, the consolidation and outsourcing of business functions and partnerships was an essential part of improving efficiency and profitability – both domestically and for international expansion. However, he added: "We are conscious of this

convergence providing a material counter-party risk, as well as loss of corporate knowledge”.

On the theme of the increasingly globalised nature of business, supply chain and business interruption risks were major points of discussion. Dexus Property Group property risk and business manager Joseph Stokes said: “In the increasingly interconnected community we live in, supply chain risk is something that is always on the radar”.

Many large organisations were already helping their suppliers to finance the building or expansion of their facilities, thereby helping to secure the supply chain.

Several risk managers said disruption in the supply chain was a complex and continuing risk that required constant monitoring because of factors such as third parties, logistics and distribution. This risk was exacerbated by the potential impact of natural disasters on supply chain companies. But many participants admitted their organisation’s planning strategy for natural catastrophes left much to be desired.

Product recall was another point of discussion. Knox said it was an issue of utmost importance to his organisation. “A product recall of a major brand could seriously damage the brand’s reputation,” he said.

Working for some of Australia’s largest companies, many participants felt this keenly. Brand risk was becoming increasingly important given the speed and reach of international media, they agreed. Reputation risk manifested itself initially in media reaction, so to manage this a solid management stance had to be in place.

‘Our reputation is critically dependent on how our people perceive, promote and represent the company’
Will Sare, UGL

Social media was fast taking over from traditional media as a means of spreading reputation risk, said Tomkinson. “Social media will soon dominate the more traditional news agencies, which may have devoted at least some resources to checking the accuracy of stories before releasing them,” he said. “Companies increasingly face the prospect of trial by social media, where the motive of the story provider can be anything from a legitimate political agenda to simply bad service at a company’s store or on their particular plane.”

Tomkinson added that the expansion of social media increased the risk of “factual but, critically, non-factual company information being disseminated to wider audiences without a company being able to appropriately manage this disclosure.

“The impact on investors, staff or customers of largely untraceable information flows put into the public domain can end up being significant, whether factual or not,” he said.

Investing in people

Sare believed investing in people was essential in managing reputation risk. “Given we are such a people-intensive business, it is clear that our reputation is critically dependent on how our people perceive, promote and represent the company,” he said. “Proactive engagement and training and investment in people systems are some of the measures taken recently to mitigate key risks to reputation and, more importantly, foster a culture that protects and takes pride in the reputation of the firm. Retaining, developing and attracting talent is essential to achieving company objectives and maintaining competitive advantage.”

Chief risk officer at Westfield Risk Management Eamonn Cunningham voiced concern about generational issues. “The next generation requires a totally different workplace and development path. They aspire to different things,” he said. “Companies need to address their reasonable needs here or they will end up with retention challenges.”

There was much talk about next-generation risks – technological trends, a new generation of consumers with different expectations, innovation pressures. Looking to the future, Sare said, in a competitive environment such as engineering and construction, market share could be won and lost based on how quickly a company adapted to change.

“As a result, we see the selection of the right business and technology partners, as well as the learning and development of our people, as critical factors in managing this risk exposure,” he said.

According to Cunningham, the smart companies always sought to innovate. He warned: “Long-standing firms that don’t will be left behind quickly.” **SR**

THEORY & PRACTICE

People matters

M&A research from Cass Business School highlights the importance of keeping the target company's key staff at the heart of the takeover deal

THE MERGER AND ACQUISITIONS RESEARCH CENTRE at Cass Business School, London, recently completed a study that provides insights into what distinguishes successful dealmakers, covering all stages in the M&A process.

The study showed, among other things, that speedy leadership shake-ups are the secret to M&A success. It found higher rates of success among acquirers who rapidly appointed top teams at their targets while also retaining a large proportion of operational staff. This article discusses the link between the results of the study and the importance of focusing on key staff during the integration period, clearly showing the risks associated with neglecting these so-called soft issues.

The recently released study, Successful Dealmaking, is based on the results from two recent projects conducted by MBA students at Cass, including primary and secondary data.

One focused on a sample of 70 large transactions completed by US and UK acquirers between 2007 and 2011, comparing those that have successfully created shareholder value with a matched sample of those in which shareholder value has been destroyed since the completion of the transaction.

The second project was a collection of primary data, using a survey of 31 professionals, focusing on their views of the role of human resources in M&A transaction success. This was complemented by seven in-depth interviews.

The prevailing rhetoric around M&A transactions is that most deals fail to deliver on their strategic promise or on lifting shareholder value. Certainly, the facts support this view, with numerous studies showing that dealmaking is far from a straightforward exercise. In fact, it could be argued that it is one of the riskiest strategies in which a corporate entity can engage.

There has, however, been some improvement in this regard. In the past, the failure rate of M&A deals has been as high as 70%, according to many studies. More recent studies have »

» suggested a success rate of between 40% and 50%. Despite this improvement, why do so many still fail? The exhaustive list of reasons is too long for this article, but difficulties around the integration of cultures and alignment of staff and strategy in the post-deal process come high up that list.

Indeed, the commonly used metaphor of a forced marriage springs to mind, certainly from the point of view of the target firm's workforce. Most employees will have no knowledge of the deal until the announcement day and little or no input into the structure of the post-merger combined firm, so motivation is often lost.

The Cass study on what makes acquirers successful highlights three issues that distinguish the good deals from the bad, and they all relate to focusing on staff, namely: the speed at which staff are dealt with and retention of personnel; focusing on HR issues early; and clear communication.

Staff retention

We found that successful acquirers were quicker to remove and replace the senior executive team, but also much more focused on the retention of operational staff. Retention rates for operational personnel were more than 60% for successful deals, compared with just over 40% for failed deals.

It is likely that failure to retain such staff would result in operational disruption, revenue loss and further loss of employees. M&A targets' top management teams – chief financial officer and chief executive officer – experience higher turnover post-completion and, here, the higher retention rates are instead found in the sample of failed acquirers.

When companies are subject to a takeover, clear communication about the reasons for the deal is an important way of ensuring staff understand and accept the significant changes happening around them. Equally important is the united front of the management team, clearly demonstrating a will to work towards the new strategic goals. The top managers from the target firm – often the founders of the business – are arguably more likely to suffer from inertia and can be set in their ways.

Focusing on HR issues

The management of people through an M&A process is generally one of the most difficult areas to get right. However, the Cass study demonstrates that HR issues are possibly the most important

Expert insight: What makes a successful M&A?

From experience, I could not agree more with the conclusions in the article that successful M&A deal-making is down to three main factors, all of which focus on staff.

But although it is important to understand the factors that lead to successful M&As, it is as important, if not more, to recognise which factors prevent corporate mergers from creating value following a deal.

As the article points out, the failure rate of M&A deals remains significantly high, at 50% or more. More worryingly, however, some M&As have resulted in a loss of value. For instance, some studies have cited that 10% of reputational damage arises from unsuccessful M&A.

The M&A failure rate is high for many reasons, but one clear pitfall is that corporates neglect to harmonise business culture following a deal. Some of the potential consequences of such failures are a high turnover rate, and unsatisfied and disgruntled staff – a negative M&A outcome that I refer to as 'brain drain' – namely, the loss of key members of staff who provide value to the business as well as the necessary knowledge and skills.

M&As certainly fell victim to this pattern before the recession. Back then, corporates were concerned only about growth and were making deals without taking the correct steps to ensure that stakeholder value would not be compromised. In the financial sector for instance, M&As were being entered into all the time.

In banks and law firms, dedicated units were set up to manage M&A deals and some would push clients into pursuing deals in order to make money, but little thought was given to how business cultures would be integrated and how the restructure would be communicated to employees. The outcome was several M&As that could not deliver on their strategic goals or, worse, a business that lost its value in the eyes of its stakeholders, clients and customers.

The situation has improved, however. As the article suggests, the M&A failure rate, which was once as high as 70%, has now reduced to about 50%. What this tells us is that businesses are becoming aware of the factors leading to failure.

But more needs to be done to address the issue and businesses should wake up to the importance of those three factors: speed of execution and retention of personnel; placing HR issues in focus early; and the importance of clear communication.

Carl Leeman, chief risk officer, Katoen Natie factor determining the success or otherwise of a deal.

Companies with a greater focus on HR – measured by the existence and use of an HR committee at board level – are more successful acquirers, the study found. There was more than twice the number of HR-specific committees in the success group than in the failure group, and about a quarter of successful deals had more HR focus. Only one in 10 of the failed deals had this.

Yet despite the importance of people management throughout the deal process, there is evidence that many companies do not involve their HR teams early enough. The second project, Reasons for M&A Transaction Success, is based on a survey of 31 HR and non-HR executives. It found that less than 10% of companies involve HR at the targeting stage, but more than 80% include the team at the integration stage.

However, most of the executives interviewed suggested that having HR involved at the earliest stage possible was important and beneficial to a deal's success. Indeed, when asked whether the problems faced by organisations post-deal could or should be resolved by HR, 93% of respondents said at least some of them could be – as long as HR matters were managed better or the teams were more involved in deals.

Clear communication

While there will always be an element of uncertainty in any M&A transaction, clear communication should result in less disruption of day-to-day activities. The results of the Cass study show that two-thirds of acquirers in the success group shared more detailed information in public announcements about their plans, compared with just a third in the failure group.

In addition, deal-killer chief executive declarations – such as "We will communicate more about the merger when we have more information to share" or "It is too early in the deal to begin planning" – were more common in the public announcements made by acquirers in the failure group. This links in with the previously mentioned point about strategic intent – when the rationale for a transaction is less clear, communication is much harder.

The importance of clear, detailed and honest communication around the announcement of a deal is often overlooked in dealmaking. Clear communication can be viewed as an extension of significant pre-planning, which should make the intent of the transaction more straightforward, both to understand and articulate.

Failing to provide clear directions for internal and external shareholders at the beginning of a deal is clearly shown in this study to have a negative impact on deal performance.

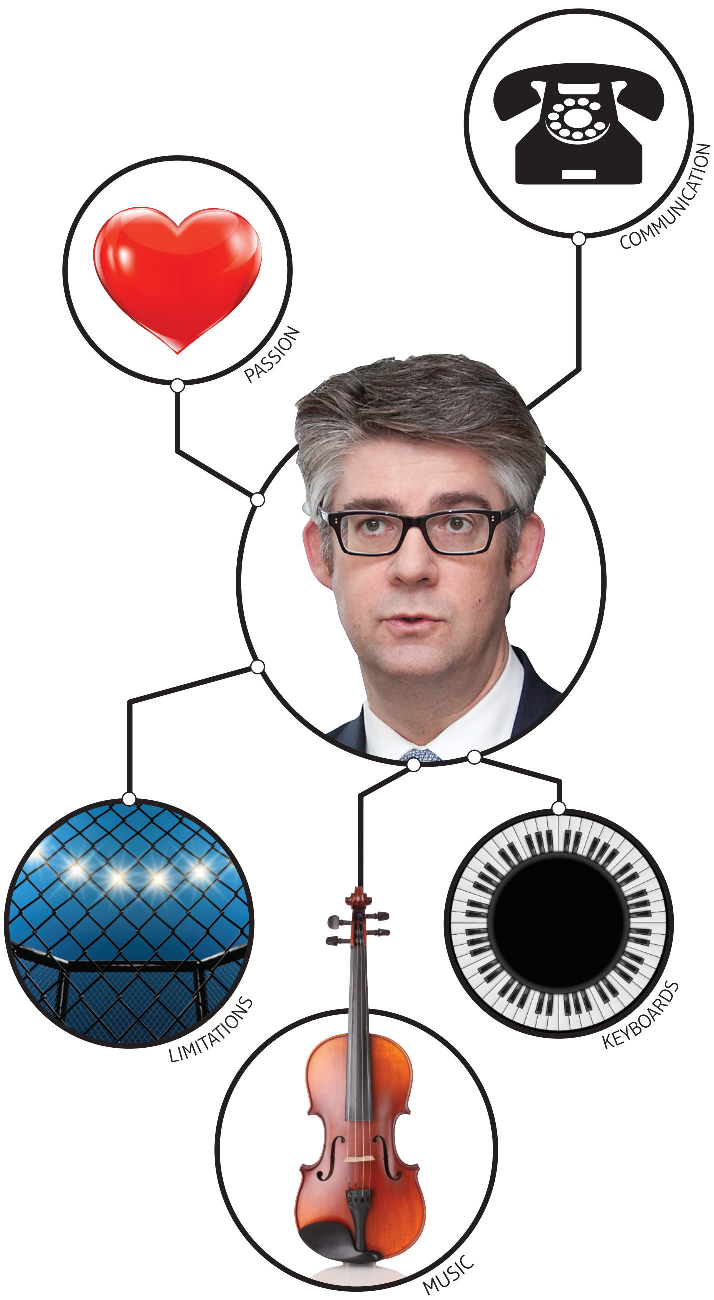
Anna Faelten is deputy director of the M&A Research Centre at Cass Business School. She has consulted for the UK government's Department for Business, Innovation and Skills on the economic impact of M&A in the UK and was also editor of corporate finance publication Deal Monitor.

The full report Successful Dealmaking can be found at www.cass.city.ac.uk/marc

While there will always be an element of uncertainty in any M&A transaction, clear communication should result in less disruption of day-to-day activities

Marco Zwick

'The way in which we decide to achieve results is equally as important as the results themselves'



What are you thinking about right now?

The past few years have presented many challenges for all internal control functions and risk managers in particular. I think that one of the main lessons learnt from the financial and economic crisis is the need for risk managers to interact more and openly communicate among themselves. There is a lot of good and, sometimes, bad experience to be shared.

What is your most treasured possession?

Persistence and passion in what I do. People occasionally focus their interest on results only, which is not surprising in a competitive world. But in my view, the way in which we decide to achieve results is equally as important as the results themselves. I apply this value in my profession as I have always considered it to be an efficient risk mitigator.

Who is your greatest hero?

For me there is no single greatest hero. There are many, and most of them do not benefit from VIP status and press coverage. Believing the definition in Wikipedia, a hero "refers to characters who, in the face of danger and adversity or from a position of weakness, displays courage and the will for self-sacrifice for some greater good of all humanity". Moral excellence is a more modern way to describe heroes nowadays, therefore I hope that the number of heroes increases daily, even though some courageous actions may benefit only a small part rather than all humanity.

What is your greatest fear?

In risk management, we deal with uncertainties, assumptions and impact assessments. We can get it wrong and recent history has demonstrated to us that risk modelling has important limitations. International regulatory standards ask for more modelling and require companies to perform back and stress tests on the models used. My concern is that risk continues to be 'virtualised' via the adoption of symmetric models based on similar underlying risk scenario assumptions. Significant risk events outside the financial industry have evidenced the need for "zero risk tolerance", for example to protect life. In financial services, we need to learn again that the objective is to manage risks, not try to eliminate them completely.

Tell us a secret

During my free time, I play keyboards, which is the perfect stress mitigation for me, but not always for my family. The advantage of playing electronic musical instruments is that you can adjust volumes and, at worst, even use headphones when hitting the keys. This has often helped me to mitigate the risk of complaints.

What makes you happy?

My eight-year-old daughter shares my passion for music and has started to play the violin. I am very happy about the musical records that we produce together. Everybody feels obliged to comment in a positive way. **SR**

Marco Zwick, president, Luxembourg Association for Risk Management (ALRiM)

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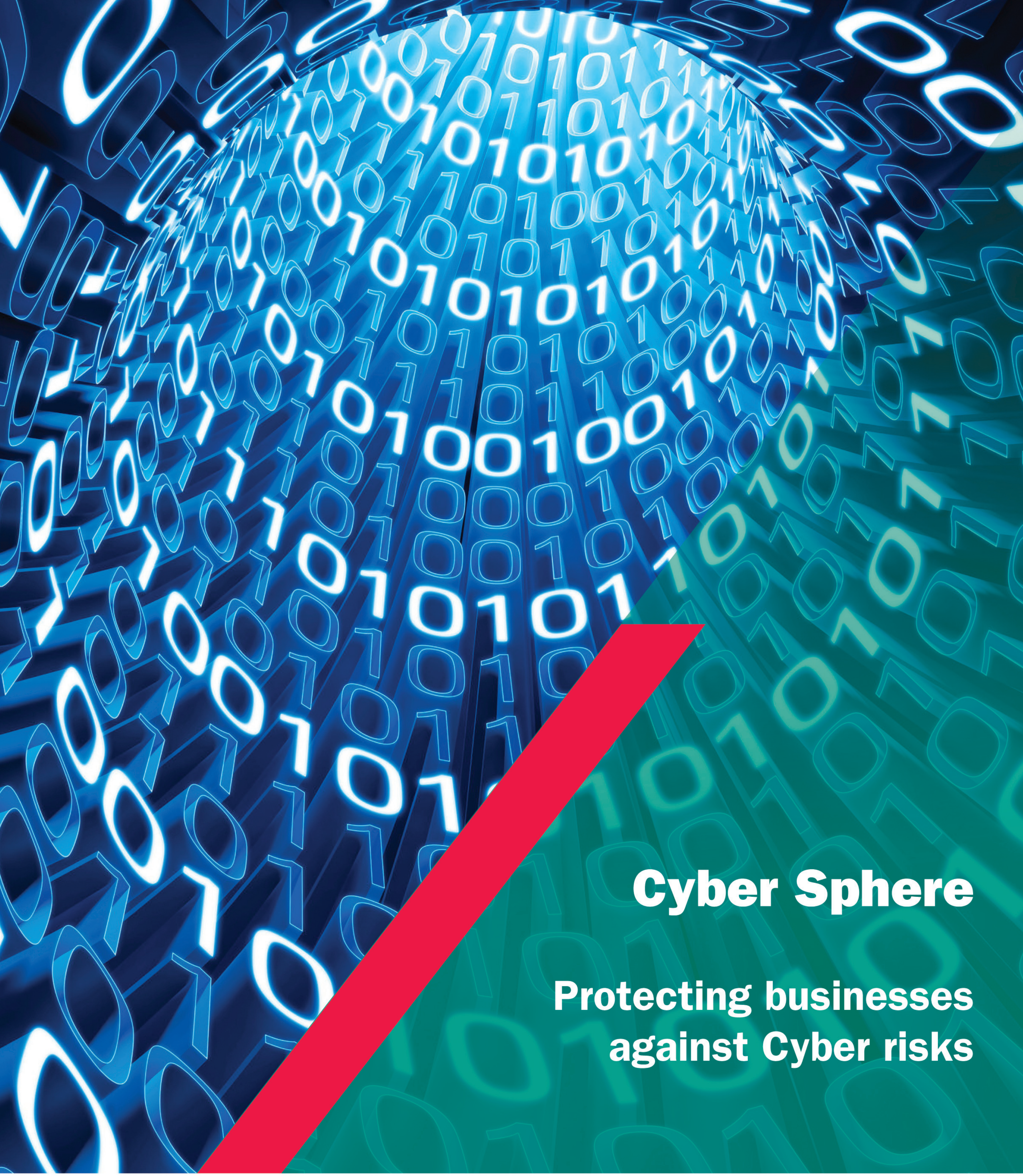

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