StrategicRISK
Risk and corporate governance intelligence

› REVIEWING THE YEAR OF RISK
› HARSH LESSONS FROM GRENFELL: HOW THE FIRE RISK FIGHT LOST PACE
› OUR POST #METOO BUSINESS WORLD
› BREXIT FOCUS: RISK MANAGERS MUST BE CENTRAL, DEAL OR NO DEAL
› WHERE DID CARILLION GO WRONG?

EUROPE EDITION [Q4] 2018 | Issue 115

# THE ON-DEMAND REVOLUTION ›

We're living in a new age of the consumer, as the sharing economy puts more power in people's hands. We must adapt our thinking to keep a grip on risk.

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Q4 2018
EUROPE EDITION

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ISSN 2517-5734

**PUBLISHED BY**
Newsquest Specialist Media Ltd

120 Leman Street, London, E1 8EU, UK

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Printed by Warners Midlands Pl



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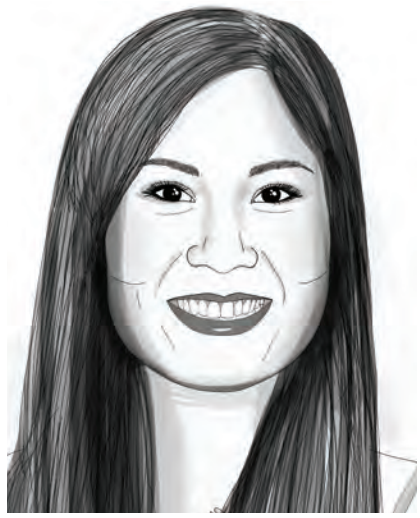
# The power is in our hands

Nobody wants to become a byword for failure to keep up. But with 2018 showing great changes in business models, everyone is under pressure to stay relevant. Be brave. Join the innovation revolution.



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Kodak, Blockbuster and Toys R Us – they all have one thing in common: they were slow to innovate and as a result, they went bust. Kodak was reluctant to build digital cameras for fear of killing its all-important film business; Blockbuster held on to its physical DVD business model while e-commerce outcompeted with online streaming options; and Toys R Us lost customer relevance due to its failure to embrace technology and adapt to changing consumer behaviours.

Nowadays, these companies are nothing more than names referenced during presentations prolifically entitled: 'Evolve or die!' But as clichéd as those words may feel, they represent the cold harsh reality of today's business landscape – companies are at great risk of insolvency if they are not fast and brave enough to, at the very least, move with the times.

To me, this is one of the greatest risks of the 21st century. Against a backdrop of highly advanced and super-smart technologies, a whole new economy has surfaced, challenging the status quo, transforming business operations, and in some cases, rendered long-held business models obsolete – with a lot more velocity than has ever been witnessed in the past.

The revolution is here! And it is in the on-demand, shared and intangible economies (see pages 12–14).

The almost overnight arrival of unicorn start-ups such as Uber, TravelCar, Airbnb, Deliveroo, Trringo and many others has taken long-established, conventional industries – farming, taxis, accommodation and food delivery – and turned them on their heads. And this has usually happened to the complete consternation of the incumbents, who failed to see the opportunity under their noses that was just waiting to be exploited.

As McKinsey points out in 'The Economic Essentials of Digital Strategy', an analysis of this mushrooming sharing-economy market, Airbnb provides an apt example. "Airbnb has not constructed new buildings; it has brought people's spare bedrooms into the market. In the process, it uncovered consumer demand – which, as it turns out, always existed – for more variety in accommodation choices, prices and lengths of stay."

In the same way, Uber didn't buy vast fleets of new cars. It simply repurposed existing vehicles and drivers and made it easier for consumers to get a ride – and, crucially, at a lower cost than the established competition.

Deploying all the tools of the connected economy, an army of on-demand and sharing economy businesses are sprouting up to service every possible consumer need in ways that some of the incumbent industries never imagined.

As Boston Consulting Group points out in a definitive study, it's here to stay. "Companies should be exploring their options in this new world of declining transaction costs and rising consumer interest in sharing. If they don't, their competitors certainly will."

But this isn't to say that start-ups are intentionally disrupting traditional models. When I met with Patrick Smith, business resilience leader for Deliveroo last month, he was keen to dispel this notion.

He said Deliveroo is transforming and enhancing the food industry, not disrupting it. To him, the platform has opened new "consumer channels that didn't previously exist. It is not questioning the way in which restaurants operate." (See pages 15–18.)

Smith went on to say this: "We have a business that is directly influenced by customer behaviour, which then uses this information to influence the food industry, with the aim of making what was previously unavailable, affordably available."

Most sharing-economy businesses seem radical at first sight but on closer inspection turn out to be perfectly logical. Businesses have an opportunity here too, not just for growth, but to influence entire industries.

Robert F. Kennedy's report to the US senate in 1966 sums up today's business revolution well: "A revolution is coming whether we will it or not. We can affect its character; we cannot alter its inevitability."

So, will we be joining the revolution? SR


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**€20bn**
total bank bailout approved by Italian government

# The year in risks

When it comes to global risk, reviewing the year that's been can feel like revisiting a lot of bad news. But the good news? There are many risk management lessons to be learnt.

## WORST EMERGING RISK: ITALY

Italian banks have been unstable for years. In 2017, the EU cleared a €5.4bn bailout of Monte dei Paschi di Siena, the world's oldest bank, pushing rescue funds to over €20bn. But in 2018, Italians banks took a turn for the worse. A radical new government declared war on the EU's fiscal rules. A stand-off is emerging that threatens to bring down the entire banking system.

Under EU rules, Italy cannot borrow more than 3% of GDP, less in non-crisis years. But Italy is in need of upgrades. The Genoa bridge collapse highlighted a national infrastructure crisis, from hospitals and schools, to bridges and roads.

The new coalition intends to break EU rules. The European Commission is threatening fines and sky-high borrowing costs for Italy, but coalition leader Luigi Di Maio says: "We will not backtrack by a millimetre." Wealthy Italians are already shifting cash to French and Swiss banks.

Worst-case scenario? Cash flight, soaring borrowing costs, downgrades, and a meltdown.

**LESSON: ITALY IS A TINDERBOX THAT COULD IGNITE IN 2019.**

## WORST NATURAL DISASTER: HURRICANE MICHAEL

When Hurricane Michael hit the Florida panhandle in October 2018, it was the third most intense in US history. Winds of 155 MPH were the fastest ever recorded there, just missing out on Category 5 status.

Naturally, Michael caused devastation along the Florida panhandle. It flipped fighter jets at Tyndall Air Force base, destroying swathes of the base at a cost of $6bn. Flying debris closed roads in Tallahassee, 130 kilometres inland.

And Hurricane Michael had already battered Central America, damaging 1,000 homes in Honduras, and leaving 200,000 without power in Cuba. Overall, 60 people died. Total cost: $11.3bn.

The question for risk managers is whether the number of storms is increasing. The answer: almost certainly. There have been 16 'above normal' hurricane seasons in the past 25 years, easily the worst period on record. The year 2017 recorded 40 'rapid intensification' hurricanes – in which at Cat 1 can accelerate to a Cat 5 in less than 24 hours. Hurricane Maria in 2017 caused $90bn partly for this reason.

The cumulative cost of weather events in the US in 2017 was $306.2bn, a rise of 50% on the previous record set in 2005. The trend is clear.

**LESSON: CAT 4 AND 5 HURRICANES ARE INCREASING IN FREQUENCY**

### FIVE COSTLIEST US HURRICANES

| | | |
|---|---|---|
| KATRINA | 2005 | $161BN |
| HARVEY | 2017 | $125BN |
| MARIA | 2017 | $90BN |
| SANDY | 2012 | $71BN |
| IRMA | 2017 | $50BN |

Source: US Office for Coastal Management

£2bn
lost by SMEs due to Carillion's demise

# WORST BANKRUPTCY: CARILLION

A duty of risk managers is to assess counter-party stability. If a trading partner goes under, the results can be traumatic: unpaid invoices, supply chain collapse, reputational damage, and more.

The starkest example of 2018? The collapse of British construction giant Carillion.

Carillion's fall offered three obvious lessons. First, margins matter. Carillion operated on wafer-thin 1.6% margins. This meant a single bad project could push the balance sheet into the red. A lo, a £845m write down of contracts pushed Carillion into oblivion.

Rupert Soames, grandson of Winston Churchill and boss of rival Serco, famously keeps a toilet brush on his desk to remind himself not to bid for work lower than a cleaner's 5% profit margin. Carillion ignored this rule to win contracts.

Second is the threat of invisible risks. An Aberdeen road bypass project was delayed by public protests, bad weather and political interventions. Costs soared, and Carillion took a hammering. Risk managers simply hadn't factored in these potential threats.

Third: the illusion of size. Carillion was seen as too big to fail. It wasn't, and 30,000 SMEs are estimated to have lost around £2bn as a result of assuming that a blue chip couldn't go under.

**LESSON: LEAN MARGINS MULTIPLY RISK.**

# WORST NEW CYBER RISK: RANSOMWARE

Ransomware is the leading new threat online, and recently, prolific malware GrandCrab scooped mind-boggling sums.

"Considering the lowest ransom note is $600 and almost half of infected victims give in to ransomware, the developers might have made at least $300m in the past couple of months alone," says Bitdefender's senior e-threat analyst Liviu Arsene.

And paying out does not always ensure recovery of files. A survey by CyberEdge showed that a quarter of ransomware victims who paid up never got their data back. Meanwhile 87% of those who refused to pay managed to restore systems. The sums involved suggest the problem is only going to get worse.

**LESSON: BACKUPS ARE THE ONLY RELIABLE SOLUTION TO RANSOMWARE.**

**77%**
of networks were breached last year

**55%**
of organisations were compromised by ransomware last year

**12%**
of a typical enterprise IT budget is spent on security

12,000
potential financial services job losses caused by Brexit

# WORST POLICY EVENT: BREXIT

Deutsche Bank's chief economist David Folkerts-Landau believes the Britain can to do "just as well, if not better" than the rest of the EU after Brexit. He's not the only optimist in the long term. But in the short term, Brexit is chalking up multiple costs for the UK economy, and in particular, the financial centre.

In terms of job losses, the hit so far is small. By July 2018, only 1,600 jobs had moved, according to the City of London Corporation. However, City policy chair Catherine McGuinness believes losses due to Brexit could reach 12,000.

But that's not the final number. The slow migration of functions to Dublin, Luxembourg and Frankfurt could create a rival infrastructure, where none previously existed. Future relations rest on mutual recognition agreements, and arbitration in the event of a dispute. At stake is the £70bn in annual taxes for the UK government, and a trade surplus of £58bn, generated by financial services.

At present, French bank Société Générale has ordered staff to relocated to France to further their careers, a potential sign of the Cold War to come.

**LESSON: POLITICAL RISKS CAN BE THE BIGGEST OF ALL.**

See our Risk Focus, page 19, for more on the post-Brexit landscape for risk managers.

## WORST DATA BREACH: INDIA'S AADHAAR

We asked UK's Penetration Tester of the Year, cyber defence services manager Mathew Ettelaie of KPMG, what percentage of big companies he could hack. His answer: "All of them."

This year Facebook admitted 87 million records had been "improperly shared" with Cambridge Analytica, allegedly violating a promise to the US Federal Trade Commission not to share data without users' permission.

Fitness app Strava released anonymised user data to create infographics. The problem? Military personnel were easily identifiable in Syria and Afghanistan.

But the worst breach of 2018? India's flagship Aadhaar biometric programme, with 99.9% of Indians enrolled, was exposed as flawed in several ways. A Google search could bring up names, parents, PAN numbers, phone numbers, religion, marks, bank account numbers, IFSC codes and other information – all this on a system declared to be unbreachable.

**LESSON: BREACHES ARE ONGOING. NO ONE IS IMMUNE.**

**99.9%**
of Indians were enrolled in the data-breached Aadhaar

## WORST CASE OF CREATIVE DISRUPTION: TESLA

When Nokia went bust, it dragged Finland into a three-year recession. Could Germany now be facing a similar risk? Tesla Motors outsold Mercedes-Benz in the US in Q2 2018. More than that, the Tesla Model 3 outsold premium sedans by all manufacturers combined. Activist investor Andrew Left of Citron Research, a vocal critic of Tesla, declared: "Plain and simple – Tesla is destroying the competition".

The threat to the German economy is huge. A fifth of Germany industry is automotive, and 78% of cars made are for export. A third of all R&D is in the sector.

Tesla holds a hand of aces: leadership in driverless tech; access to cobalt reserves needed for batteries; a squeaky-clean brand; no fossil division to manage; and industry-leading impact safety. A report by Berenberg Bank said investors had under-estimated Tesla's finances, margins and battery systems.

When Netflix first appeared, the chief executive of Time Warner Jeffrey Bewkes dismissed the threat, saying: "It's a little bit like – is the Albanian army going to take over the world?" We all know how that turned out.

**LESSON: GERMAN INDUSTRY IS FACING A WAR WITH INSURGENTS.**

## WORST NEW RISK TO THE ECONOMY: A US TRADE WAR

"I would say the policies that are embraced by the US administration around trade represent the biggest risk today to the global economy." That's the warning of Philipp Hildebrand, vice-chair of BlackRock, the world's largest asset manager, and former chair of the Swiss National Bank. Hildebrand points to president Donald Trump's tariffs imposed on $250bn worth of Chinese goods as evidence of a concrete risk, adding: "You have some very exposed countries."

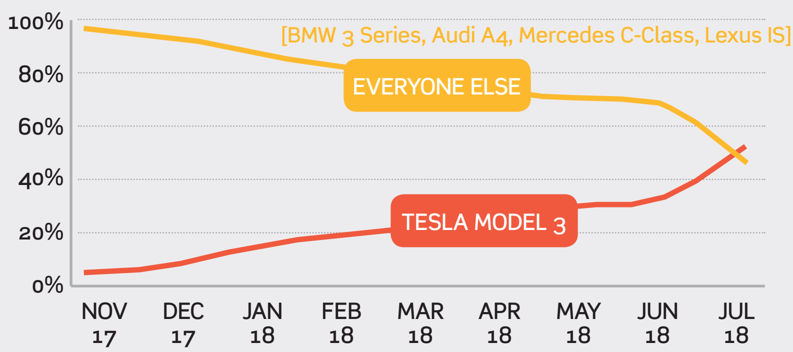
China tops the list of vulnerable nations, but Canada and the EU spent much of the 2018 fighting arbitrary tariffs introduced by the US. In January 2018, Trump introduced tariffs on solar panels and washing machines of 30–50%. Steel and aluminium tariffs followed.

Risk managers must prepare for retaliation, leading to disruption for export markets and supply chains, and ripple effects as interrupted parties seek to recoup costs.

China's richest man, Alibaba founder Jack Ma, called the US-China trade war "the most stupid thing in the world", saying it would be the US who lost most from such as dispute. No resolution is in sight.

**LESSON: TRADE WARS ARE BACK.**

### MID-SIZED PREMIUM SEDANS: US MARKET SHARE




## PRICE OF COBALT


# WORST COMMODITY CRISIS: THREE "C"s

A shortage of a commodity can send a shock wave through global supply chains. Current flashpoints? Copper, cobalt, and coal. Copper hit prices spiked in 2018 due to strikes at the world's largest copper mine, Escondida in Chile, plus an acceleration in global demand. Further strikes in Chile, where 27% of global ore is produced, pose ongoing risks.

Coal shortages are a persistent problem in India. The Northern provinces rely on coal for power. Shortages trigger power cuts, causing disruption to industry. The Aluminium Association of India asked the government to stop prioritising supplies to power plants to prevent further chaos in the metals industry.

Cobalt is a key ingredient in electric vehicle batteries. A London Metals Exchange forum on cobalt heard a deficit is forecast for the next three years. Production is slowly responding, starting with a ramp up of production in the DR Congo, leading to a price dip, but the future remains turbulent.

**LESSON: VOLATILITY IN COMMODITY SUPPLY AND DEMAND CHALLENGES SUPPLY CHAINS.**

# WORST HEALTH RISK: SLEEP DEPRIVATION

"The Simplest Way to Drastically Improve Your Life: More Sleep." This recent *New York Times* headline captures the Zeitgeist of 2018, in which sleep, or the lack of it, was the #1 health concern.

Sleep problems are now known to cause dozens of health problems. Sleep neuroscientist Matthew Walker wrote in his bestseller *Why We Sleep*: "Routinely sleeping less than six or seven hours a night demolishes your immune system, more than doubling your risk of cancer."

Add to this an increased chance of Alzheimer's, cardiovascular disease and stroke. The ability to remember information plummets. Even one bad night of sleep a week can raise blood sugar so profoundly to qualify as pre-diabetic.

It used to be that 2% of Americans were sleep-deprived. Now it's a third. Sleep is a major risk for doctors and other medical professionals, in the armed forces, and in boardrooms as exhausted executives perform erratically.

Sleep is a clear health and commercial risk. Proctor & Gamble and Goldman Sachs offer sleep clinics. It is time that others should, too.

**LESSON: EMPLOYEE SLEEP LEVELS MUST BE TAKEN SERIOUSLY.** SR

**30%** of Americans are sleep-deprived (getting six or fewer hours per night)


# Did we neglect fire risk?

Previously well-contained, the fight against fire risk appeared to lose momentum in favour of new, more captivating risks like cyber crime. Then came Grenfell.

**"PEOPLE HAD SAID, 'SOMETHING'S NOT RIGHT HERE,' AND THEY WERE NOT LISTENED TO."**

Head of risk and compliance, Arcadia Group
**Colin Campbell**

In the spring of 2017, a survey of Airmic members found that attitudes to fire risk in the profession were overwhelmingly relaxed. At that time, fire was rated a top risk by as few as 10% of risk and insurance managers, and just 7% anticipated that fire would be a high-level risk in the coming three years. The months that followed changed that thinking, as heartbreaking scenes unfolded at the Grenfell Tower housing block in North Kensington, London, in June – taking 72 lives.

Since Grenfell, blazes in buildings have continued to hit the UK, and across the globe, a different kind of first risk played out during the summer of 2018. The Glasgow School of Art was engulfed by fire in June 2018. The category A listed building, designed by Scottish architect and artist Charles Rennie Mackintosh, had gone up in flames four years earlier, amid a high-profile renovation project, but had not been fitted with a sprinkler system.

Two months later, in Belfast, Northern Ireland, 1,500 staff and shoppers were evacuated safely from a large Primark clothing store situated in the Grade B1 listed Bank Buildings, part of which was undergoing a €33.5m redevelopment. In fact, the news has been filled with fire stories, many linked to building renovation projects.

After 10 or 15 years of declining incidence of fires, did the risk and insurance community lose interest in fire risk? "Twenty or 30 years ago, fire was considered much more of a risk," says Colin Campbell, head of risk and compliance at Arcadia Group, which operates 2,805 high street stores in 37 countries.

"Around the late 1980s and early '90s, everyone got together to work to prevent fires causing loss of life, and property damage," says Campbell. "It was business, insurers, the regulators, government and the fire brigade all wanting to get it right."

This shared ambition to reduce the number and severity of fires was realised over the coming decades, aided by better building regulations, new technology such as sprinkler systems, and heat and smoke detectors, the 2007 ban on smoking in public places, and improved risk management practices. In November 2013, *The Times* reported that in 2011 firefighters had attended 48% fewer fires overall and 39% fewer in buildings compared to a decade earlier.

"Did we, as a profession, take our eye off the ball?" Campbell asks. "I don't know… but it's important to remember that these type of events do happen. … People had said, 'Something's not right here,' and they were not listened to."

## SAFETY NOT TAKEN SERIOUSLY

Grenfell Tower was refurbished with new cladding and windows in 2016. The ongoing Grenfell Tower Inquiry has heard evidence that residents at that time raised concerns about safety with Kensington & Chelsea Tenant Management Organisation, but were not listened to.

In addition, post-Grenfell research has suggested there was limited interaction between fire safety engineers and risk and insurance professionals. The Hackitt Report, an independent review of building regulations and fire safety that was commissioned in the aftermath of the fire, and published in May 2018, highlights weaknesses in the Building Regulations 2010, including particularly Approved Document B, which covers the requirement for testing or assessing the fire safeness of external cladding systems.

Hugh Forster, managing consultant at Marsh Risk Consulting, says: "It has become obvious that the building regulations, particularly Document B, are extremely difficult to use, and that there has been a disconnect between the fire safety engineers designing the buildings, using Document B, and the insurance side of the business." Forster, who is a member of the Institute of Fire Engineers, adds that among the 20,000 people in the UK who conduct fire safety assessments, only around 800, or 4%, are registered competent.

The shortage of skilled assessors was revealed as companies wished to review their estates post-Grenfell. "What Grenfell did was to really bring home fire and health and safety risks," says Asif Bhatti, director of

## POST-GRENFELL LESSONS

• **LISTEN AND ACT** The appropriate people need to listen to what all stakeholders are saying about fire and safety, and to act on it.
• **COMMUNICATION** Interaction between fire safety engineers and insurance must be improved.
• **IMPROVE FIRE DOORS/SMOKE VENTING** More knowledge is coming to light as a result of the post-Grenfell research effort.
• **CHANGE FOCUS** Resource must not just manage new risks, but conventional risks like fire.
• **TRAIN ASSESSORS** More must be registered who are competent for the size of the job.
• **EVALUATE PROCEDURES** Organisations need to review their policies and procedures regarding evacuation and invacuation, or staying put, during a fire.

audit and risk at Whitbread, a hospitality company that operates 785 Premier Inn hotels and 2,400 Costa coffee shops. "There appear to have been multiple failures. When you get ambiguities in the regulation, which is what people are saying, then it's not fit for purpose."

After the disaster, Whitbread completed a comprehensive review of the cladding on all of its buildings, as well as other fire safety components such as doors and stairwells, in what Bhatti describes as a "complex process, working for a year, and taking a hell of a lot of resource. Our response was very, very thorough."

Echoing Forster's comment about a shortage of service providers to support such activity, Bhatti says: "Suppliers of cladding and retrofit have a waiting list of years, because there are only a handful of them. And the fire testing facilities are now fully booked." Arcadia and Whitbread, among many others, also reviewed evacuation procedures after the fire.

### LESS INTRIGUING BUT NECESSARY

Bhatti, who also chairs Gloucester City Homes, a housing association that manages 4,862 homes, including one tower block, believes it's imperative for risk professionals to review the balance of time and energy given over to managing conventional risks such as fire, compared to "more complex and sexier risks – like the risk of being attacked by a Russian hacker". "I wouldn't say that the profession was neglecting fire risk, just not focusing on it as much as we used to. Those of us managing risk day to day are inundated by cyber, data breach, GDPR. These risks are potential brand-killers, and it's a lot on the horizon to keep your eyes on."

He believes that in focusing overly on emerging risks such as cyber, familiar risks like fire may be downplayed. "Most car accidents occur within a mile of the home, because drivers are familiar with the conditions and become over-confident. It's easy to become distracted by the brand-killers, and to forget that there are people-killers out there," he says.

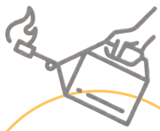
"There was an immediacy to the response, but that is now settling down," Campbell concludes. "All of the research and investigation that is going on post-Grenfell, whether it's understanding the dynamics of fire, smoke and smoke venting… it's all continuous learning. We may not have taken our eye off the ball, but is there any room for complacency? The answer is no." **SR**

**"WE ARE INUNDATED BY CYBER, DATA BREACH, GDPR. THESE RISKS ARE POTENTIAL BRAND KILLERS, AND IT'S A LOT ON THE HORIZON TO KEEP YOUR EYES ON."**

Director of audit and risk, Whitbread
**Asif Bhatti**

## A YEAR OF WILDFIRES

**Soaring temperatures, dry conditions and multiple arson attacks have caused devastating wildfires across the globe.**



**84%**
of US wildfires are started by humans (1992–2012)

**CALIFORNIA**
The 2018 wildfire season is the most destructive on record in California, with a total of 8,434 fires burning an area of 1,890,438 acres (at time of press). In August, a national disaster was declared due to extensive wildfires across the region. In November, a new batch of wildfires claimed 85 lives, and destroyed more than 18,000 structures.

**1.89m**
acres alight

**8,434**
fires blazed

**104**
total lives lost

**100**
firefighters fought blaze

**UK** In July, a wildfire caused by arson blazed across 2,000 acres of Saddleworth Moor, Manchester, attended by more than 100 firefighters, and military.

**PORTUGAL** As temperatures hit 47°C in the Algarve in August, the five-star Macdonald Monchique Resort & Spa resort, and residents of nearby villages, were evacuated when a forest fire broke out.

**47°C**
temperature highs

Number of wildfires in Europe in 2018
**43%**
higher than 10-year average

**83**
lives lost

**500**
homes destroyed

**GREECE** A state of emergency was declared, with 83 people killed and more than 500 homes destroyed, as wildfire swept through Mati, near Athens, caused by a suspected arson. In September, a wildfire broke out near crowded refugee camp Moria, on the island of Lesbos.


# Beyond #MeToo

Businesses can no longer turn a blind eye to gender discrimination and toxic culture. And if ethics don't motivate, maybe shareholder displeasure and brand damage will.

When two former employees filed a lawsuit against Nike alleging gender discrimination and hostile workplace environments this year, it showed the lasting impact of the #MeToo movement, and its wide-reaching implications across business, entertainment, politics and religion.

A survey published by leading UK gender equality and women's rights charity Fawcett Society revealed a significant change in attitudes over the past 12 months, with people of all ages more likely to call out inappropriate behaviour.

But more needs to be done, argues the charity. It recommends the government reintroduces third-party harassment laws and introduces a new duty on large employers to prevent discrimination and harassment in the workplace. "Employers have to take responsibility for their own workplace culture," says Sam Smethers, Fawcett Society chief executive. "Older men have to be part of the change because they often hold positions of power. But their attitudes are lagging behind."

**"BANTER IS SOMETHING THAT HAPPENS BETWEEN FRIENDS. BANTERING CANNOT HAPPEN BETWEEN SUBORDINATES AND THE PEOPLE WHO ARE MANAGING THEM."**

Director of course development, VinciWorks
**Nick Henderson**

#MeToo is the global movement against sexual harassment and sexual assault was sparked by allegations of predatory behaviour by movie mogul Harvey Weinstein. The hashtag #MeToo quickly spread across social media. "The good thing about the #MeToo era is that people feel empowered to talk about things that have happened to them in the past," says Nick Henderson, director of course development at compliance training firm VinciWorks. "No one should go unpunished for behaviours that are illegal, unprofessional or unethical."

## ABUSES OF POWER

In the case of Nike, the issues raised by the federal lawsuit, which includes sexual harassment, look more broadly at a hostile culture that had deliberately ignored gender discrimination and inequality. The former employees allege Nike habitually hired women at lower salaries, discriminated against them in performance reviews and failed to promote female talent as frequently as their male counterparts.

The company hierarchy was described as an "unclimbable pyramid". It is understood the lawsuit could eventually become a collective action involving over 500 women, both current and former staff.

"If you have a business culture where women are paid less, where they are promoted less, where they're seen as being 'less than'," Henderson says, "then it's going to logically follow that other people in the workplace will feel they can harass, discriminate and even abuse and assault women in the workplace, because they don't feel they are equal to them and so they don't have to treat them the same."

"No workplace can be free of inappropriate behaviour and there's not going to be a situation where you have a harassment-free workplace," he continues. "But you have to have strong policies in place to prevent a toxic workplace culture where harassment can happen, and to be able to properly investigate claims of inappropriate behaviour. And it has to be part of a wider strategy whereby you are promoting more women to make sure there is a diverse group of people at every level of the organisation."

He thinks training is essential as a way of raising awareness and talking about boundaries. "Businesses should really be thinking about the training they've got and whether it is just a tick-the-box exercise to protect them from liability. Training needs to make people feel that they can report something that's happened and identify behaviours that aren't okay."

"Banter is something that happens between friends and mates – it's not something that happens with people who are unequal in a workplace," says Henderson. "Bantering cannot happen between subordinates and the people who are managing them."

### DON'T CROSS THE SHAREHOLDERS

The initial lawsuit against Nike was followed by a second suit brought by shareholders, which targets the company's board of directors, and names former brand president Trevor Edwards as a defendant along with chief executive Mark Parker. The investors claim Nike's directors breached their fiduciary duty by "knowingly" ignoring a "hostile work environment that has now harmed, and threatens to further tarnish and impair (Nike's) financial position, as well as its reputation and goodwill".

"With investor actions, what they're basically saying is that the board turned a blind eye to the long-standing culture of harassment and discrimination, and as a result of that, the board breached their fiduciary duty and wasted corporate assets," says Eleni Petros, employment practices liability insurance practice leader at broker Marsh.

"So in this instance, the process of holding the company and its executives accountable for permitting this culture is not only about the lawsuit of the people who are affected, but also the shareholders who allege the directors failed in their duties to the company and harmed the company as a result."

The ramifications of the Nike case could be significant, with the potential for more shareholder class actions expected to arise in the US as a result of similar litigation. Julia Graham, technical director of Airmic, thinks risk managers need to approach issues such as gender discrimination as an enterprise-wide issue. Just as cyber risk is no longer the sole domain of a company's IT department, so employment risk is no longer an HR issue alone.

"It's about collaborating across all those different silos to understand what your culture is, how that translates into the business and what you would like it to be," she says. "And then you need to be very sure that you're upholding that and if necessary, even at a senior level, coaching your leaders to make sure you deliver that mission and those values. You should be coaching those senior people so they know how to respond properly if something goes wrong."

**"IF YOU'RE NOT CONVINCED BY DOING THE RIGHT THING, THINK ABOUT THE COMMERCIAL ASPECT, BECAUSE IT CAN BE DAMAGING."**

Technical director, Airmic
**Julie Graham**

### A BRAND KILLER

Crisis management and communications also have an important role to play in mitigating the reputational fallout from allegations of sexual assault and sexual harassment. Commentators argue that Nike's internal culture of marginalising women was at odds with how it portrays the brand as valuing women in sports and that this has damaged the trust in the brand.

"If you're not convinced by doing the right thing, think about the commercial aspect, because it can be damaging," says Graham. "Are talented women going to want to go and work for a company that doesn't treat them with respect? Probably not."

As the examples of Philip Green, president Donald Trump and Cristiano Ronaldo demonstrate, it is not always possible to prevent the accused from behaving in ways that cause further damage. "One problem is when you have people who are almost as big as the business," says Graham. "When you have big egos and big personalities, it's not an easy thing to deal with and it's not always within your control."

"In organisations the size of Nike, where there are big corporate cultures, I don't think there is any excuse, because they're not dealing with the Elon Musks and the Philip Greens," she continues. "For these people, having good advice can save a lot of heartache. And Nike does have good crisis and business continuity plans – I know some of the people who have written them – but they clearly didn't follow them." **SR**

## WHERE DOES THE BUCK FALL?

**Concern that employment practice claims will increase in the aftermath of #MeToo is fuelling demand for EPLI cover.**

Marsh EPLI practice leader Eleni Petros notes that #MeToo, along with other trends such as the rise of the gig economy, has increased many organisation's exposures to employment risk.

"Employment risk is increasingly a risk management issue," Petros says. "As a business you need to make sure you have the correct practices and procedures in place and that you have the right tone in the organisation. If that fails and you get claims, you need to make sure you can protect yourself. There are more claims in the US, so a lot of companies have EPLI policies – because they are the ones that will respond to a claim against the organisation, and typically these claims are made against the organisation rather than an individual. But we're certainly seeing an up-tick in enquiries from clients about EPLI insurance as a result of these issues."

There are also implications for directors and officers. "If we are talking about claims against the board of directors for not fostering the right corporate culture, that's not an employment practices discrimination, it's about corporate culture. And that will hit the D&O policy because that is a claim against directors for not fostering the right corporate culture and thereby breaching their fiduciary duty."

# Power to the people

In the sharing and on-demand economies, customers have the upper hand, and they are using this to drive prices down and standards up. Companies must be proactive as they enter a whole new world of risk.

France's PSA Group, manufacturer of the Peugeot, Citroen, Opel and Vauxhall marques, is one of the latest automotive giants to jump into the sharing economy.

In October, PSA raised the stakes in its fight against the likes of Uber and Lyft when it rolled out its Free2Move car-sharing service in Washington, DC. At once, Free2Move put 600 vehicles, available 24/7, into the capital. The automotive giant has full control of the service – it will own and manage Free2Move in the city.

Previously, PSA Group had worked with a variety of other transport-sharing operators. Already active right across Europe, Free2Move is available in 12 countries with a fleet of cars, vans, scooters and bicycles, and lists 1.5 million users. Madrid alone is home to 180,000 clients, according to the company.

## CONSUMERS IN THE DRIVING SEAT

PSA's strategy reflects very closely what consultants McKinsey outlined in a briefing two years ago called 'The Economic Essentials of the Digital Strategy'. Namely, consumers are now holding the cards. "By embracing technology and connectivity, today's consumers use apps and information to find exactly what they want, as well as where and when they want it – often for the lowest price available," McKinsey pointed out at a time when the rise of Uber was shocking the transport giants.

As McKinsey adds, companies that fail to appreciate the new-found power of the consumer are heading for trouble. Its analysis cites several vulnerabilities in traditional business models that make them ripe for disruption. In short, the clock is ticking for companies unprepared for the sharing and on-demand revolution.

More than ever, risk managers must have their finger on the pulse when it comes to competition risks, particularly from disruptive innovators, says Patrick Smith, global business resilience consultant at on-demand food delivery company, Deliveroo: "Every company in every industry is on some kind of transformation journey. Some lead from the front, some organisations are brand new and some will be hundreds of years old with the entrenchment that this suggests. But the economic revolution dictates that doing business the way that we've always done it doesn't work anymore."

"When we live in a world of ultimate consumer choice, in a social environment driven by technology, being slow to change can't work. If your business model does not continually adapt and flex, it will be called out."

For traditional corporates, this could mean digitalising operations for the benefit of consumers – a trend often referred to as digital transformation. Indeed, on-demand and sharing-economy companies, whose business are built on digital and mobile applications, have shown that going digital really pays off. If you needed convincing, the growth

**"THE ECONOMIC REVOLUTION DICTATES THAT DOING BUSINESS THE WAY THAT WE'VE BEEN DOING IT DOESN'T WORK ANYMORE."**

Global insurance and business resilience leader, Deliveroo
**Patrick Smith**

of five key sharing economy sectors – automotive, hospitality, finance, staffing and media streaming – is projected to rise from $14 billion to $335 billion by 2025, according to PwC.

There are huge sums at stake for these companies, and so the risks must be well managed.

## AN INSURANCE HEADACHE

"The sharing economy gives rise to new risks and unique insurance challenges," warn Jose Heftye, managing director and sharing economy practice leader at Marsh and Robert Bauer, AIG's managing director, commercial innovation and head of its sharing economy practice group, in their definitive analysis of the phenomenon. And, as they report, this means a lot of headaches for the insurance industry.

In their report 'Insuring the Sharing Economy', Heftye and Bauer cite risks such as uncertainty over who pays the medical bills for an injured freelancer such as an Uber driver, or paid time off for bereavement or disability, and other events that are traditionally covered by employee compensation schemes. In 2016, for example, French ride-sharing drivers went on strike over working conditions amid accusations that their companies did not provide any insurance coverage. (For more on how Patrick Smith is tackling this particular issue with Deliveroo, see page 15.)

"Here's a very practical example about gaps in insurance coverage," Bauer says.

"If you're an independent contractor offering services on a ridesharing app, and you're driving on your own without your app on, it's pretty clear that your personal insurance would cover an accident. On the other hand, if the app is on and you've got a paying customer in your back seat, most likely the rideshare company is on the hook for that.

"But there's a whole lot of 'what ifs' that happen in between. What happens when the app is on and it's looking for a rider? Are you 'working' or are you 'driving to work'? This is the messy part in the middle that insurers are figuring out now."

This is where strong risk management is critical. "I work on certainty first," says Smith. "It is my job to understand the risks better than anyone."

He adds: "Deliveroo takes risk knowingly, day in, day out. Every organisation, whatever their business, takes risks, so it is no less important for on-demand and sharing economy platforms to have very rounded sensible conversations about what risks should be absorbed, avoided and transferred. Understanding the risks and having cohesive plans is key to resilience.

"I have found that discussing traditional risk management concepts in a jargon-free way and using the language and metrics that the organisation uses is key; and progressive for both of us."

And for the risks that need to be transferred to the market, risk managers will need to work with their insurer on building bespoke policies, because they are in their infancy.

"Insuring the sharing economy is more like playing chess than checkers," says Bauer. "Pricing models are being constructed with loss history that is just beginning now. Some types of insurance remain highly regulated. Lines between personal and commercial insurance are blurred -– based on mixed use of assets and labour. Regulators are open to new ways of thinking, but they are also just catching up."

**"INSURING THE SHARING ECONOMY IS MORE LIKE PLAYING CHESS THAN CHECKERS. PRICING MODELS ARE BEING CONSTRUCTED WITH LOSS HISTORY THAT IS JUST BEGINNING NOW."**

Head of sharing economy practice group, AIG
**Robert Bauer**

## THROUGH ITS FINGERS

And yet, while prime for growth, on-demand start-ups are not immune to insolvency risks. For starry-eyed proponents of the sharing economy, the demise of Autolib' in Paris serves as a cautionary tale. An electric car-sharing service launched in late 2011 by the Bolloré conglomerate amid great enthusiasm, it ran up debts approaching €300 million, according to the parent company, and in mid-2018 the Paris authorities refused to extend its licence.

By the time Autolib' shut down, it had 4,000 cars available at more than 1,100 self-service docking stations positioned in the city and surrounding suburbs, but was losing money hand over fist.

According to Autolib', it fell foul of a rejuvenated taxi service. Lately, nimble fleets of mini-cabs have provided an Uber-like service, promising a ride within ten minutes at a fixed charge, regardless of traffic congestion. An alternative reason cited by some for the car-sharing service's failure was the deteriorating state of the cars, which were often left dirty and untidy. They were also used as beds by the homeless.

Reading between the lines, Autolib' lacked the managerial resources and financial depth to run its car-sharing company. And the travails of Uber's former chief executive Travis Kalanick, now sitting on the board, illustrate how some start-ups lack the professionalism embedded in old-economy companies. As the automotive giants such as PSA fight back, they must not make the same mistakes. **SR**

# Risk appetite

Much more than a food delivery service, Deliveroo serves up vast amounts of big data – and fresh new risks – daily. It relies on business resilience leader Patrick Smith to stay creative.

Everything about Deliveroo screams entrepreneurship and innovation. From its trendy office, which is exactly what you might expect from a new-age tech company (big, bright, lounge-style and open-plan, complete with a one-acre rooftop garden) to the people (high-energy, super-smart, creative types who eschew the corporate dress code). This feels like an environment where great things happen.

Technology, plus creativity and innovation are the catalysts for Deliveroo's meteoric rise from start-up to a business that has transformed the food industry, and in just five short years. But it is the risk management story that is truly inspiring here, and it is fuelled by the same level of gusto and creativity that Deliveroo has become known for. The man helping to drive it? Patrick Smith, Deliveroo's global business resilience and insurance consultant.

In 2013, the company was launched with one simple mission: to deliver upmarket restaurant meals to the masses, but Smith sees the company's identity as anything but simple.

"Is Deliveroo a food delivery service? Yes, it's passionate about food" he says. "Is it a digital platform? Absolutely, it's that too. Does that make it a technology company? I guess you could say that."

So what is Deliveroo really? "A big data company," Smith states. "Deliveroo uses its digital platform to seamlessly connect hungry customers with restaurants and those who offer their service to deliver this food. The app creates and uses a lot of data that provides the intelligence about who

wants to eat what and where – that's powerful. How this data is used is what makes Deliveroo more than just a food delivery service."

## REAL FOOD, VIRTUAL RISK

The company's impressive growth reflects just how big its big data potential is. Deliveroo's on-demand mobile app is the jewel in its big data crown and is what earned it a reputation as one of the pioneers of the burgeoning gig and on-demand economies.

The app connects hundreds of thousands of people to about 50,000 restaurants in 200 cities and 13 countries. About 50,000 freelance riders around the world make deliveries within, it claims, just 30 minutes of an order, 24 hours a day, seven days a week.

With such a large digitally connected network, the food delivery company is gathering data on just about anything and everything concerning its restaurants, riders and customers. From food preferences to operational matters: it knows what food is trending (potatoes in all varieties: mashed, fried, sweet, according to one report); and which cities like their curries very spicy or very mild (in the UK, Cardiff takes the title for 'spiciest city', while Coventry keeps it mild).

On the operational side, it can match delivery demand to consumer activity and orders based on its algorithmic calculations of food preparation times; and as soon as a health and safety incident has taken place, it can react and resolve it quickly, and anticipate and proactively reduce the risk of future issues.

Although core to its business, its fame comes from more than just a snazzy app, says Smith: "Will Shu, our chief executive, was recently named one of the top food influencers by UK newspaper, the *Telegraph*. This isn't just because he developed a fast-blown digital platform, it's because Deliveroo is using its platform to influence.

"We have a business that is directly influenced by customer behaviour, which then uses this information to influence the food industry, with the aim of making what was previously unavailable, affordably available. This is terrifically exciting."

Its newest data-inspired venture? A series of delivery-only kitchens strategically placed near to areas showing unfulfilled demand for good-quality restaurant food – all guided by intelligent big data analysis and customer insight, of course.

These 'virtual kitchens' are a new phenomenon in the rise of the intangible and gig economies. From London to Singapore, Paris to Hong Kong, Deliveroo's satellite kitchens are being set up across the world in purpose built or developed units. Fully equipped and close to its customer base in residential and office areas, these kitchens give restaurant brands access to untapped markets, customer demand, as well as a network of freelance riders – without the overheads of a physical restaurant.

They represent a new reality of 'virtual branding', in which a restaurant's food takes centre stage and where a restaurant's reputation is measured mainly on this and none of the other indicators of brand quality for bricks and mortar restaurants (such as front-of-house customer service, food presentation and ambience).

This is the potential of the intangible economy, where businesses can achieve huge success by owning little more than a mobile app, digital platform or online booking system (think Uber, Airbnb and arguably, co-working office space provider, WeWork). Even the world's most successful businesses, Apple and Amazon, while selling physical products, achieved market dominance on more nebulous concepts: algorithms, models and brands.

And traditional corporates are not shying away. They too are becoming 'asset light' – in fact, more than 80% of S&P500 businesses are made up of intangible assets – data, intellectual property and brand.

It is against this economic backdrop that Smith is managing a whole host of 'newer' risks and an elevated level of uncertainty. And it is these more strategic risks of reputation, people, cyber and IP – the risks connected to the company's brand, mission, ethos and future – that trigger and excites Smith's seasoned risk radar.

**"WE HAVE A BUSINESS THAT IS DIRECTLY INFLUENCED BY CUSTOMER BEHAVIOUR, WHICH THEN USES THIS INFORMATION TO INFLUENCE THE FOOD INDUSTRY. THIS IS TERRIFICALLY EXCITING."**

## THE GREAT PROTECTOR

It is for this reason, to defend the reputation and brand Deliveroo seeks to stand by, that Smith is keen to dispel the notion that tech start-ups in the new economy are 'disrupting' their respective industries.

"Deliveroo is transforming, enhancing and somewhat pioneering the reach and capability of the food industry. I'm not sure it is disrupting it," he asserts.

"The Deliveroo model helps restaurants cook more food that people want to eat. It is opening consumer channels that didn't previously exist – it is not questioning the way in which restaurants operate but allowing them to develop. It is building another layer of opportunity for restaurants and customers, using technology and data intelligently to make it happen."

So important is this mission that it filters right down to every single level of the company. "Deliveroo's model is a business playbook for its people and operations in all territories. There isn't a 15th floor, with a special lift for executive management – everyone is together. The company operates on the concept of 'shadow of the leader' and everyone understands their role in delivering Deliveroo's strategic objectives. However, the devil – or the risks to our brand – is in the detail."

Anything that could harm or enhance Deliveroo's hard-earned reputation takes priority. "Deliveroo is very smart in understanding the importance its brand image has on its existing and future value," Smith says. "Deliveroo cares about how it is perceived by customers and stakeholders, and ensures that it takes good care of them. This is what I love about Deliveroo. It has a laser focus on doing business properly so that its people, kitchens, freelance delivery riders and consumers are fully protected."

Of course, Deliveroo has been no stranger to public criticism. Recently, the level of protection that gig-economy businesses offer to freelance workers has come under scrutiny. Self-employed workers are generally not entitled to protections such as minimum wage, holiday and sickness pay. Politicians, unions and trade associations have been fervently campaigning for these conditions. Deliveroo's response? To build a global insurance programme that can offer better protection.

"The big difference between traditional organisations and the Deliveroo model is that the people who deliver food are not employed by Deliveroo – they are freelance. And they value the flexibility and freedom that freelancing affords," says Smith. "Deliveroo's ambition is to be market leaders in the gig economy for protecting freelance riders who offer their services to the platform."

"So, I have been focused on building a suite of solutions that can offer new and leading protection and security to riders when on the job, while respecting and not prejudicing their benefits of freelancing."

The culmination of this work is a free-of-charge insurance programme, with annual premiums of about £10 million. It provides coverage for medical costs, income loss owing to accidents, fixed benefits for serious injuries and third-party liability coverage to riders on the road. The company says it is "more substantial and wide-ranging than comparable products for those working in the on-demand economy".

**"IT IS A STRONG CULTURE OF TRUST THAT PROTECTS OUR IP. DELIVEROO, UNRESERVEDLY, TRUSTS ITS EMPLOYEES TO UNDERSTAND WHAT THE GAME IS."**

People-related risks involving in-house members of staff take a different guise, however, being more closely linked to intellectual property. Deliveroo operates a culture of collaboration and sharing, backed by a clear vision.

"When you are a creative organisation and constantly expected and supported to think innovatively, bounce and try new ideas, then it is vital that you know which are commercially sensitive and should be protected and kept confidential.

"So, when it comes to people, the concerns are not restricted to traditional people risks but the level of IP and know-how that our people hold and the risk of it being inadvertently leaked or lost."

This is where corporate risk culture becomes a strong risk management tool, explains Smith. "Managing IP-related risks comes down to having a set of strongly defined business values and behaviours. In any environment of fluid exchanging of ideas, it is a strong culture of trust and high motivation with clarity of vision that protects our IP. Deliveroo, unreservedly, trusts its people to understand what the game is and to be part of a family that makes things work. That's just the way Deliveroo is."

## ACT LIKE THERE IS NO INSURANCE?

Crucially, insurance can't be your only armour to defend against these intangible risks.

"If you start managing any issue from the point of asking insurance-related questions, protecting intangible risks becomes very hard, because suddenly you frame the question around what insurance can or cannot protect; whether it wants or doesn't want to provide coverage. For me, I take a 'risk first' approach in the context of the particular strategic aim. What is it that we are trying to achieve? That done, I see insurance as only one risk management opportunity," Smith says.

"The challenge is not necessarily in understanding what the risk to intangible assets might be, but the size and velocity of that risk. To what degree will it threaten the company's strategy? What does a risk scenario look like and how would we deal with it if an event occurred?"

## DELIVEROO: BY THE NUMBERS

**The food delivery empire is global, connecting tens of thousands of people to local restaurants and collecting vast amounts of data.**

**200** cities

**13** countries

**50,000** freelance riders

**50,000**



**Time taken for your order to arrive at your door**

Instead, the story should begin with the notion that all risks are uninsurable. "Act like there is no insurance and plan for the risk scenario. If your data is stolen, for example, what are the recovery steps that would protect your business strategy and objectives? What resources should be deployed and prioritised? What are the crisis management, business resilience, business continuity, and disaster recovery plans? These plans then need to be tested and simulated. To me, that's real practical risk management that the business can engage in."

### WHAT'S THE TAKEAWAY?

These 'new' risks are what excite Smith and why he was keen to accept the challenge when Deliveroo first approached him in July 2017. "I knew that accepting the assignment with Deliveroo would expose me to a different world from the one that most corporates are challenged by, and that it would evolve and be a journey in itself."

"I've spent many years in traditional environments, where I was responsible for insurable risks. But now having experience in both traditional and creative businesses, allows me to help fix a huge issue. The issue is this: creative organisations have new and different risks but are relatively new to risk financing, risk transfer and insurance, and so arguably, they can struggle to articulate their needs."

"Conversely, you have providers of risk financing, risk transfer and insurance, who have age-old policy wordings and historic and embedded ways of operating. How can they align with new and changing risks of today, and respond to new fast-growing organisations with fresh business models?"

It just takes imagination, he believes. "You need strong risk managers to fight the corner of the creative organisations in a way that stimulates creativity in service providers, helping them to unleash their strengths and capabilities in a different way."

"Most insurance is offered as an annual contract. Deliveroo is not an annual business, so immediately, I'm thinking, how do I remake traditional risk or insurance to address this different type of problem? My approach to risk has been enhanced by working in places like Deliveroo and other companies and industries. I import different ways of thinking and evaluating risks," he says. "I can cite several examples of times I have gotten neat things done because I have started in a completely different place."

**"YOU NEED STRONG RISK MANAGERS TO FIGHT THE CORNER OF THE CREATIVE ORGANISATIONS IN A WAY THAT STIMULATES CREATIVITY IN SERVICE PROVIDERS."**

Smith isn't afraid to challenge the status quo. His philosophy for managing complex risks of new economies is to learn from the old – his traditional roots – and embrace the new.

For all the digital innovation and let's call it 'disruptive transformation' that Deliveroo has delivered, it has also challenged traditional risk and insurance management – for the better. And you thought Deliveroo was set up to simply to deliver food? **SR**

## PATRICK SMITH'S RISK RÉSUMÉ

**Deliveroo's global business resilience consultant is passionate about bringing out the creativity in traditional service providers, to best serve the new creative companies in our new gig and on-demand economies.**

As global insurance and business resilience leader, Smith sits on Deliveroo's advisory board of corporate risk. In addition, he is executive director of Specialty Protection Services, a niche specialty consultant focused on developing innovative risk and insurance programmes for affinities, digital platform providers and the hospitality and entertainment sector. Here Smith is also a gig economy freelancer. "It's the direction that employment is going in," he says.

He also founded Acumen Advisory in 2015 – a management consultancy focused on strategy, risk management frameworks, global insurance and captive programmes and optimal organisational design and transformation. Previously, he held roles as chief risk officer of The Warranty Group, and international director of risk, insurance and claims management for the Hertz Corporation.

Smith was also a former chair of Airmic and now leads its academy programme of risk workshops, alongside Airmic's partners.

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# Breaking up is hard to do

Businesses are largely still in the dark over exactly what Brexit Day will bring next March, but practical plans need to be devised and enacted now. And risk managers must be central in preparing for every eventuality, deal or no deal.

# Time to strategise

Brexit Day is looming, and negotiations continue to hit stalemate in parliament despite Theresa May having already agreed a deal with the EU. But this must not stop risk managers developing plays for every outcome if they want to protect their business from whatever the future holds.

Fast forward. It's 29 March 2019 – Brexit Day – the date that, just two years after prime minister Theresa May triggered Article 50 to get the wheels turning, Britain leaves the EU.

Her predecessor David Cameron certainly would not have anticipated this moment when announcing that the country would be holding a referendum to determine the UK's future relationship with Europe, but what seemed like the unthinkable for many has come to fruition, and the big EU experiment is over.

Rewind back to the present day, and politicians on both side of the channel are still working frantically trying to come up with a deal for how trade will work in our upcoming post-Brexit world that is acceptable to all parties. At the time of writing, the prime minister is yet to broker a deal she can pass through parliament, and with every day that goes by, the prospect of a no-deal Brexit grows increasingly likely.

In the worst-case scenario of a no-deal Brexit, the pessimists speak of tailbacks at the channel stretching for miles as businesses collapse under the pressure and bureaucracy of attempting to trade across borders without adequate rules to govern them. Optimists will stiffen their upper lip and say things will work out, we just have to get on with it.

The truth, as always, will likely lie somewhere between the two.

Of course, the 29 March deadline is the date that the UK will officially leave the EU, but May has already negotiated a 21-month Brexit transition period under which the UK will continue to follow EU rules as if nothing has changed. So it may not be until December 2020 that the dust settles and businesses can finally see what they have to work with.

**"WHILE I'M CONFIDENT THAT WE WILL GET A DEAL, SENSIBLE RISK MANAGEMENT DICTATES THAT WE SHOULD PREPARE FOR A NO-DEAL BREXIT."**

Immigration consultant, Clyde & Co
**Jonathan Chaimovic**

But what could this post-Brexit landscape look like? And what can risk managers do to make the path to a fully operational post-Brexit Britain just a little bit less perilous?

## KNOW YOUR EXACT BUSINESS NEEDS

Carl Leeman, chief risk officer at multinational logistics company Katoen Natie, says it is impossible to determine exactly how business will work post-Brexit, so risk managers need to be fully aware of their business's precise situation, and what the different possible outcomes of Brexit negotiations could mean going forward.

"As a risk manager, you cannot predict what is going to happen with Brexit – no one can," he says. "You have to prepare on a number of scenarios that may play out, and those are very different from one company to another."

"Some companies will not have any issues after Brexit, while others will face a lot of issues. So, as a risk manager it is important that you really understand the type of activities your business has and how they link to the UK."

of clarity in terms of the route that will be taken makes it difficult to plan from a risk perspective."

"There are practical things that can be done, but it is just a real mixed bag across the industry as to whether or not these actions are taking place."

To help better understand his own business, Leeman sent out questionnaires to all of his suppliers to determine what exposure the business had to the UK.

**FEAR OVER UK LINKS**

"The most dangerous situation surrounding Brexit is one that we have already tackled in our business, and that is not being aware of your own dependence on the UK," he says.

"We have an engineering department where we build equipment, and we don't directly buy any parts from the UK, but after questioning our suppliers, we found out that some of our second- and third-tier suppliers do have items coming from the UK. We are now in the process of assessing if they can buy those goods from somewhere else or what the price difference may be once the UK does leave the Europe, and whether those parts could take longer to be delivered."

**"THE MOST DANGEROUS SITUATION SURROUNDING BREXIT IS ONE THAT WE HAVE ALREADY TACKLED IN OUR BUSINESS, AND THAT IS NOT BEING AWARE OF YOUR OWN DEPENDENCE ON THE UK."**

Chief risk officer, Katoen
**Carl Leeman**

David Hansom, procurement law specialist at law firm Clyde & Co, says businesses need to act before it is too late.

"A number of organisations have put in place the strategic, fundamental decisions they need to be able to continue trading after any type of Brexit. Outside of the multinational space, however, Brexit may be on board agendas for many businesses, but the message we are getting is that this hasn't turned into operational work yet," he says. "There is an issue of Brexit fatigue in the wider population, and the absence

**PROTECT YOUR PEOPLE**

In the run up to the Brexit vote, the issue of immigration was a hot topic that for many was one of the pivotal factors driving the choice to leave the EU. And the importance of this topic has not changed.

Theresa May might have been favouring a deal whereby EU nationals would receive preferential treatment in any future post-Brexit immigration framework, but the signs are now that EU and non-EU nationals will likely be treated equally.

And despite politicians' talk of protected status in the event of the UK leaving the EU without an immigration deal in place, there has been no unconditional unilateral acceptance by the UK Government of the Citizens' Charter, nor the EU Settlement Scheme.

For Jonathan Chaimovic, consultant in Clyde & Co's employment, pensions and immigration team, the threat that this presents to foreign workforces means that risk managers need to prepare for the worst, no matter how certain they are that of a deal being finalised.

"While I'm confident that we will get a deal, sensible risk management dictates that we should prepare for a no-deal Brexit," he says. "That means people, where eligible, should formalise their status now – citizens of EU countries should look to obtain permanent residence in the UK, while UK citizens working in EU countries should look for equivalent residency status for the country in which they are based."

The same applies to businesses; Chaimovic says those that do not already have a tier-two licence (currently only applicable to employing non-EU nationals) should consider applying for one now to cover employing EU nationals following Brexit.

Chaimovic also advises companies that, where feasible, they should be accelerating start dates of EU nationals in the UK and UK citizens in EU countries before 29 March 2019, to cover a no-deal Brexit.

**GRAB THE MIC**

The most important piece of advice, however, could come from Airmic deputy chief executive and technical director Julia Graham. She says the first task for risk managers is to make sure they are in a position of power to effect change within their own organisation.

"We have been telling our members from almost the moment the referendum results were in that Brexit is a prime example of why risk managers need to be seen by their businesses as business partners," she says. "That is because the risk manager really needs to be in the business team to be able to influence and support what the business is doing in its response to Brexit. You can't have the impact needed if you are not invited to that business group and hold a position of influence.

"It seems blindingly obvious, but there are still a lot of risk managers who struggle to get their business to see them as business partners as opposed to a back office technician, and when it comes to Brexit you really do need to be seen as a business partner." **SR**

# Choppy waters for supply chains

However Brexit plays out, the impact on international trade is likely to be great. As forecasted border delays threaten to sink UK manufacturing, supply chain managers are acting now.

"THE UK ECONOMY COULD FALL OFF A CLIFF ON BREXIT DAY IF GOODS ARE DELAYED BY JUST MINUTES AT THE BORDER."

Economist, Chartered Institute of Procurement and Supply
**John Glen**

For those against the UK's decision to leave the EU, one of the biggest factors in their position is the threat Brexit presents to international trade. At the moment, borders within the EU offer free movement of people and goods, and those goods are traded tariff-free in a frictionless environment aimed at making trade easier and profitable for everyone.

When the UK leaves the EU, all that stops, and with it customs checks at borders become the norm. For supply chain managers, the risks are huge.

A survey of 1,310 EU and UK-based supply chain managers conducted by the Chartered Institute of Procurement and Supply (CIPS) found that 10% of firms believe their businesses would likely go bankrupt if goods were delayed at the border by 10–30 minutes. This increased to 14% for delays of one to three hours, and 15% for delays of 12–24 hours.

CIPS economist John Glen says even small delays at the border could be devastating. "The UK economy could fall off a cliff on Brexit Day if goods are delayed by just minutes at the border. Businesses have become used to operating efficiently, with lean, frictionless supply chains, and quick customs clearance."

And Glen is right to be worried. With the deadline for the UK leaving the EU looming large, there is still no deal in place as to how these customs borders, and other issues, will be dealt with after Brexit Day on 29 March, with prime minister Theresa May forced into an eleventh-hour delay of a parliamentary vote on the withdrawal agreement out of fear of a crushing defeat.

In the CIPS survey, the majority of supply chain managers said they needed at least a year to prepare their business once a deal has been agreed. This is time they might not get, even with the 21-month transition period negotiated by May.

### JUST-IN-TIME IN JEOPARDY

To help mitigate these risks, Clyde & Co procurement law specialist David Hansom says businesses need to be evaluating their supply chain and determining whether their existing contracts are still fit for purpose.

"The key thing is to look at supplier contracts, and this will typically involve a long list of different contracts that work together to keep the business going," he says. "It is about finding those high-level business-critical contracts and checking whether they offer protection for any type of Brexit. We have a lot of clients who are looking at variations on those contracts to take into account exchange rate fluctuations that may affect the cost of delivery of goods, and the potential inability for suppliers to deliver components."

Hansom says this level of preparedness is particularly important given the nature of the UK's manufacturing industry.

"The UK manufacturing industry is now very much component-based, instead of building the whole good, so the just-in-time supply chain, and the insurance requirements and delivery deadlines that go with that, need to be looked into and stress-tested," he says. "Some companies are already stockpiling parts or diversifying their supply chain so they can source from elsewhere if needed."

For Russell Group chief executive Suki Basi, this threat to the just-in-time supply chain is one of the biggest risks. "In today's connected world, corporates' supply chains are spread across different countries and this approach has led many manufacturing organisations to perfect just-in-time supply chain management methods."

"Brexit threatens to undermine all of this. The imposition of tariffs on British goods, along with a hard border, would undermine this just-in-time production strategy. Without seamless borders, key components needed from the supply chain would not reach the production process. This would not only create delays in the production process, but lead to other risks such as financial loss as share price plummets and reputational impact, as the company fails to deliver its orders."

The CIPS survey found 24% of the supply chain managers were planning to stockpile goods, while 4% already are. A fifth are introducing more flexible contracts, and the same percentage are already looking for alternative suppliers outside the EU.

Multinational logistics company Katoen Natie is one EU-based business that is already putting such measures in place for suppliers that are exposed to the UK market.

Chief risk officer Carl Leeman says: "We prepared a checklist that we sent to our suppliers to fill out, so we are aware if there are any important parts or goods that we currently buy in the UK that could lead to issues in the future, post-Brexit. If some of the parts for the products that we sell are only coming from a UK supplier, then we are asking that supplier to see if they can source the goods from elsewhere. If they can't, then we are looking at what the impact could be on the price of the goods and the time it takes for them to be delivered."

### START… YESTERDAY

The truth is that 48% of respondents said they could not begin to make any preparations as future trade arrangements were still too unclear, and half of companies said they would struggle to find suppliers and skills in the UK after Brexit.

**"IF YOU ARE JUST THINKING TO PLAN NOW, YOU ARE TOO LATE – SOME OF OUR MEMBERS STARTED DOING THIS THE MONTH THE VOTE WAS CAST."**

Deputy chief executive, Airmic
**Julia Graham**

To help deal with this lack of clarity surrounding a post-Brexit trade deal, Airmic deputy chief executive and technical director Julia Graham says businesses should be making use of scenario-testing to prepare for a wide range of difference possible scenarios. And that they need to be doing it now.

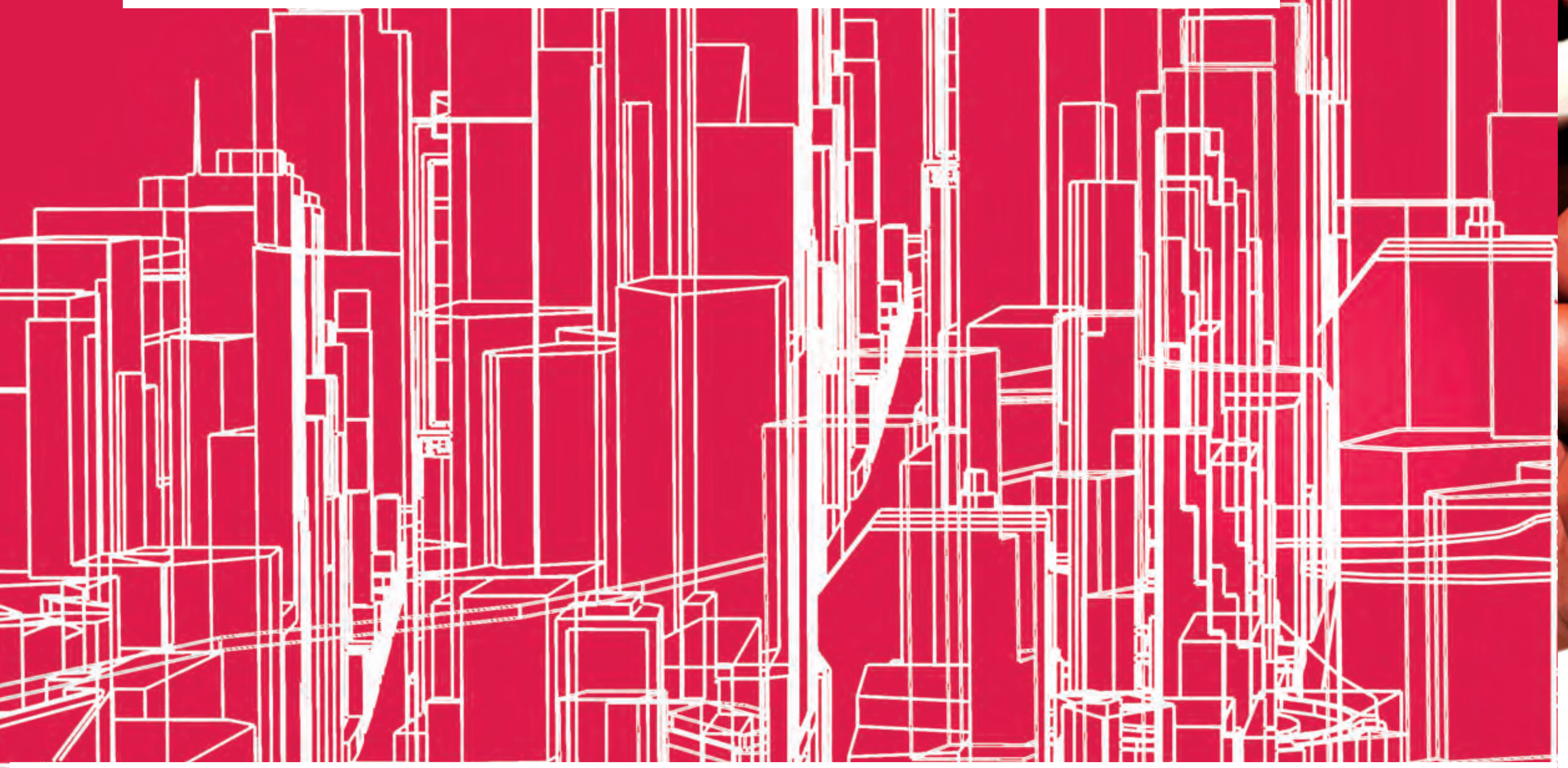
"You'd be a fool not to run scenario testing on a wide range of different possible outcomes, ranging between deal and no-deal," she says.

"You have to think of the extremes – if a deal is done and things are good, or that there is no deal and things are less good, as well as the variations in between. You then run your scenarios on those variations, and that is just what businesses have been doing for some time. If you are just thinking to plan now, you are too late – some of our members started doing this the month the vote was cast."

Ultimately, Katoen Natie's Leeman says businesses just need to be ready to adapt to whatever post-Brexit landscape they are faced with. "You have to be able to adapt quickly to new and changing situations, and it is the same with Brexit. You have to be vigilant and quick to adapt to the new environment – after all, that is the new normal for businesses now." **SR**

# Toppling down

It has been a turbulent two years for the construction industry. First, the Grenfell Tower fire caused deep tragedy and millions of pounds of damage. Seven months later, Carillion plunged into liquidation. Both show just how complex construction risk has become.



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# Recklessness, hubris and greed

Carillion did practically everything wrong, yet its sudden demise has sent shockwaves through the business community. A harsh spotlight will now be focused on directors and officers liability and transparency.

As successive inquiries uncover evidence of, in the words of the damning parliamentary inquiry into its collapse, the "recklessness, hubris and greed" that led to the fall of Carillion, the post-mortems are turning into a case study on how not to run a company.

And the investigations are widening all the time, bringing in every entity involved – auditors, executives, directors, consultants and even government bodies accused of failing to act soon enough.

The mismanagement cited by the parliamentary inquiry was of such a scale that it may yet lead to further action against executives and directors. The inquiry recommended that the Insolvency Service investigation into the conduct of former directors "includes careful consideration of potential breaches of duties under the Companies Act, as part of their assessment of whether to take action for those breaches or to recommend to the Secretary of State action for disqualification as a director".

As revelations continue to emerge, they make an inarguable case for directors and officers and other forms of boardroom insurance, even for exemplary directors, as shareholders become more distrustful and more aggressive.

The Association of British Insurers said in a statement: "These types of products, such as professional liability, have always been important for anyone in a senior position in a business."

### REGULATORS ARE ON THE CASE

Evidence of the failures within Carillion is being told in millions of words. A team at the Financial Reporting Council (FRC) is still sifting through tens of thousands of documents – audit files, KPMG's and Carillion's emails and company papers – as well as interviewing KPMG and Carillion employees, as it trawls through the final four years of the company's accelerating decline.

If the FRC's executive council determines it has enough evidence to clear the legal threshold and bring disciplinary actions, it will do so. The FRC's main focus is on two former finance directors.

The Insolvency Service, Financial Conduct Authority and Pensions Regulator (TPR) are also on the case. For instance, the Competition and Markets Authority is looking at the audit market to see whether new regulations would reduce the long-standing monopoly of the Big Four.

**"WE NOW INTEND TO ENHANCE OUR FOCUS ON THE AUDITS OF COMPANIES THAT APPEAR TO BE IN DANGER, AND SHOULD LIKE THIS TO BE COMBINED WITH AN ABILITY TO CALL OUT WHAT WE FIND."**

**Financial Reporting Council**

Stung by criticism levelled in the parliamentary report, the FRC also wants to have its say over audits. The body has expressed a wish to be enabled to issue its own assessments in future on the audits of those companies that are deemed to be on the brink. "We now intend to enhance our focus on the audits of companies that appear to be in danger, and should like this to be combined with an ability to call out what we find," the FRC has said.

### DEMANDING BETTER STEWARDSHIP

Taken as a whole, the Carillion collapse has unleashed a fury of forensic analysis that will inevitably lead to a much brighter spotlight being shone on the boardrooms of major companies and will put directors under considerably more pressure.

A probably inevitable consequence of all this activity will be reform of the Stewardship Code. As soon as the FRC has finished a review of the Corporate Governance Code, it will start on the issue of better stewardship. The main purpose is to look at whether the code is sufficiently effective, but also whether companies and investors can engage more constructively with each other. One possible outcome is the obligatory appointment of a class of go-betweens – intermediaries who

## TIMELINE OF A COLLAPSE

**Carillion toppled in early 2018 after giving every appearance of being in good health until a year earlier. Here are the milestones leading to its demise.**

**MARCH 2017** Carillion paid a record dividend of £79m including fat performance bonuses to senior executives. Of this, £55m was disbursed as late as June 2017.

**£79m**
record dividend paid

**JULY 2017** Exactly a month after handing out the remaining £55m, and four months after publishing the 2016/2017 accounts, it announced in a general profit warning a reduction of £845m in the value of its contracts.

**SEPTEMBER 2017** The reduction was increased to £1,045m, shocking the markets. As the parliamentary inquiry points out, this sum was equivalent to Carillion's *entire profits* in the previous seven years.

**£1,045m**
Final reduction in the value of Carillion's profits

**JANUARY 2018** The company went into liquidation with previously unheralded liabilities of £7bn. Its total cash pile was £29m. Carillion's pension liability is about £2.6bn and it owed some £2bn to 30,000 suppliers and other short-term creditors.

**£2.6bn**
Carillion's pension liability

act as proxy agents between board and investors' representatives.

Carillion's shareholders say they had little idea what was really going on – and the FRC wants this to change. "Statements by companies in the annual report about their governance can fail to provide real insight, and investors can find them hard to challenge," the organisation pointed out in July in an update of its progress on the Carillion investigation. As a result, the FRC wants more powers, including the right to undertake a report into the quality of governance in systemically important companies.

Another influential organisation to strike a blow for better corporate governance is the Chartered Institute of Internal Auditors (CIIA), which in September urged the FRC to toughen its proposed principles for large private companies "by more closely mirroring measures contained within the UK Corporate Governance Code for publicly listed firms". It also wants the regulator to "take charge of monitoring the application of the principles".

The CIIA was referring specifically to the collapse of BHS, but the failure of Carillion only serves to strengthen its case. "The collapse of both BHS and Carillion highlighted a number of corporate governance shortfalls," Gavin Hayes, the institute's head of policy and external affairs, told *StrategicRISK*, pointing out how that the failure of both companies had a catastrophic impact on their workforce, customers, suppliers and the wider economy.

"That's why, going forward, it's fundamental that we ensure we have a strong corporate governance framework in place that promotes greater transparency and accountability."

## HURTLING TO FAILURE

Meantime the parliamentary report should be compulsory reading for risk managers and anybody who holds a position of responsibility in a big company. As the report tells it, Carillion did practically everything wrong over a period of years as it hurtled towards an inevitable failure.

"Its business model was a relentless dash for cash, driven by acquisitions, rising debt, expansion into new markets and exploitation of suppliers," the report summarises. "It presented accounts that misrepresented the reality of the business, and increased its dividend every year, come what may."

If that wasn't bad enough, the report accuses the board of increasing and protecting "generous executive bonuses" while Carillion was beginning to unravel. Conclusion: "Carillion was unsustainable."

Yet Carillion was a company that prided itself on corporate governance and saw no need for mandatory external reviews. In 2010, on the occasion of a general review of the UK code, the board wrote to the corporate governance unit of the FRC to point out that it was "among the first [publicly listed companies] to adopt a policy of detailed and rigorous board evaluation in 2002, and has used the process to adapt board process, procedure and governance" ever since. The company did not consider mandatory external reviews to be "necessary or appropriate".

**"CARILLION'S BUSINESS MODEL WAS A RELENTLESS DASH FOR CASH, DRIVEN BY ACQUISITIONS, RISING DEBT, EXPANSION INTO NEW MARKETS AND EXPLOITATION OF SUPPLIERS."**

**The parliamentary report into Carillion**

The Carillion board also opposed annual re-election of directors because "it could place in jeopardy the level of continuity essential to the management of a complex business" as well as "threaten the independence of thinking necessary to achieve effective collective responsibility". At that time, Carillion may already have been running into trouble – it had tripled in size between 2002 and 2010.

## A LITANY OF ERRORS

Few are coming out well from the post-mortems in what is turning into a general indictment of big business, causing long-lasting reputational damage by default. The entire system of checks and balances in the economic system has been brought into question by the parliamentary inquiry because they manifestly failed to work in the interests of investors. It's clear that UK's biggest resources company, responsible for building everything from roads and hospitals to providing school meals and defence accommodation, had been spiralling out of control for a long time.

Among other deficiencies, the inquiry cites:

- Failures by non-executive directors to challenge or scrutinise reckless executives.
- Systematic manipulation of the accounts "in defiance of internal controls".
- KPMG's "complacent signing off" of the accounts over a period of 19 years as auditor; Deloitte's failures in its role of risk management and financial control as internal auditor; and EY's "six months of failed turnaround advice."
- The key regulators – the FRC and TPR – also come in for a hammering for their "feebleness and timidity" in failing to follow up and use their powers after concerns were raised. Both organisations were described as "chronically passive" and requiring "cultural change". (In its defence, the FRC reminded the inquiry that following the July profits warning it was already investigating Carillion with a view to taking enforcement action when it collapsed.)

The Carillion post-mortems are still under way, but they're all pointing in the same direction. And that is much tougher oversight of the boardroom. **SR**

# In the wake of Grenfell

## Tougher codes and penalties are putting pressure on the building industry's insurance cover, while raising questions over how far down the line liability should go.

The series of inquiries that followed the Grenfell tower disaster have greatly widened the insurance implications relating to high-rise residential accommodation, affecting just about all those responsible for the design, construction, maintenance, management and ownership of tower blocks of all kinds. So far, building codes are being rewritten, enforcement tightened and penalties for breaches increased. In short, commercial entities along the chain of command are in the firing line in the event of any failure to meet considerably broadened legal responsibilities.

In the UK, tighter enforcement, tougher penalties and more closely scrutinised accountability will result from the independent review of the building and fire safety regulations issued in mid-May 2018.

Applying to residential buildings of 10 or more stories, among other recommendations the review urges clearer responsibilities and accountability be imposed on "duty holders" – those in designated positions of oversight. Additionally, new enforcement powers will be given to a Joint Competent Authority composed of the health and safety executive, fire and rescue authorities, and local authority.

Under these imminent new laws, law firm Clyde & Co notes, duty holders will likely be in the firing line for up to twice as long as currently. And the time limit for taking action "should increase from two years to five to six years from the time of the offence".

A number of organisations could face ongoing legal action. In the case of Grenfell, that could be the tenant management association, companies involved in the refurbishment work, suppliers, and designers and manufacturers of any materials deemed to be suspect.

### WE MUST ALL LEARN SOMETHING

The lessons being learned – and the inquiries are far from complete – have spilled across international borders. In the wake of the tragedy, other countries are taking a long hard look at the safety of high-rise accommodation, particularly but not exclusively in terms of aluminium composite cladding, which has become one of the most debated issues.

As far away as Australia, for instance, state governments are drawing up laws that have significant downstream implications for liability. As a result, Australian companies involved in construction are re-examining their cover in terms of professional indemnity, directors and officers, and corporate manslaughter.

In the UK, the debate continues about who pays for the removal of cladding deemed to be at risk, another important insurance matter. Following a ruling in the London's First Tier Tribunal involving the Citiscape block in Croydon in early 2018, the onus seems to have fallen on the leaseholder.

However, liability is likely to go further down the line. As Victoria Dacie-Lombardo, managing associate at law firm Mischcon de Reya, pointed out in a report in May: "Many leaseholders will therefore look to recover these costs elsewhere," citing a string of likely targets that include landlords, developers, building contractors and engineers, local authorities as well as the government.

The report adds to this: "Another potential target could be home construction warranty and insurance providers such as the National House-Building Council. In each case circumstances are unlikely to be clear-cut and leaseholders will need to establish a claim in either negligence or breach of contract."

Rather than risk damage to their reputations, some construction companies may decide it's more prudent to do the work anyway, as Barratt Developments has promised in the case of the Citiscape block. Although Barratt pointed out the building conformed with the regulations current at the time of construction in 2001, it will undertake retrospective and future safety measures at a cost of several millions of pounds.

### INDEMNITY HAS ITS LIMITS

In cases like Grenfell, with so many inquiries still taking place, there is considerable uncertainty about the extent of indemnity. "There is often a concern as to whether there are sufficient limits in place," explains EC3 Legal in a prescient report. "If not, then insureds will be looking for other policies that might pick up some of the losses, or other deep pockets to offload blame and liability."

But without adequate cover, directors could face financial ruin. "D&O cover for individuals and entities is important, especially for smaller companies with limited liability as well as for smaller PLCs," says Martin Bridges, technical services manager for the British Insurance Brokers Association. "The key is to obtain cover for the entity [because] D&O often has limits in terms of legal costs. Not everybody has a spare half to two million pounds lying around to cover their legal expenses."

EC3 Legal agrees, particularly given the possibility of criminal investigations. "In our experience, companies historically have not bought sufficient limits of such cover," says EC3 Legal, pointing out that investigations and representation can be expensive. Some insurers limit cover, for example, to £5m. But that normally provides for legal costs and not fines.

### CONVICTIONS DO HAPPEN

Charges of corporate manslaughter present potentially catastrophic financial and reputational risks. As data provided by Protector Insurance shows, citing statistics from the UK Health and Safety Executive, the construction industry accounted in 2017–18 for the highest number of fatal injuries and has the highest annual average for 2013–2014.

Although convictions for corporate manslaughter have been far from common in Britain since the appropriate laws were passed in 2007, they do occur. Construction firm Martinisation was convicted of the corporate manslaughter of two workers who died in a fall from a first-floor balcony in London in 2014 while trying to hoist by ropes a sofa from the pavement. The court ruled the deaths to result from a substantial breach of duty.

"There must be a breach of duty by the company," Protector Insurance risk engineer Donal O'Hanlon told *StrategicRISK*. "And the way in which the business's activities are managed must be considered to be a substantial element of the breach."

Deaths can however happen in seemingly unlikely industries, such as finance. That's why O'Hanlon suggests: "I would say that corporate manslaughter cover is important across all sectors and industries." **SR**

## AUSTRALIA: LITIGATION ON THE RISE

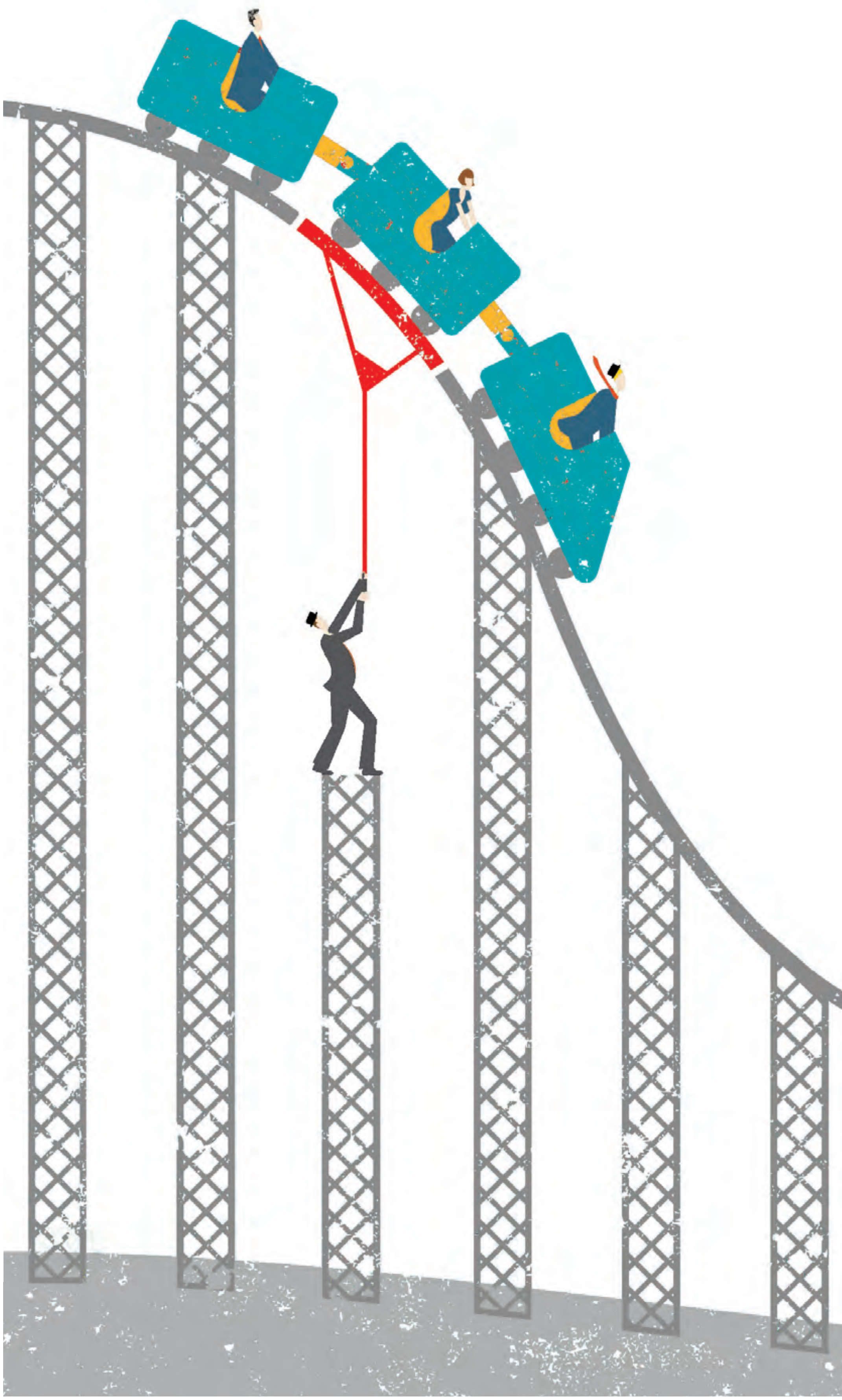
**Spurred into action by Grenfell and their own high-rise fires, Australian authorities are piling more responsibility on the construction industry.**

In mid-May, a year-long inquiry in Queensland found that flammable cladding may have been used on as many as 12,000 buildings in the state. Nearly 50 buildings are under investigation, including several hospitals. In Victoria, an audit of 170 buildings established that 51% of high-rise buildings failed to comply with the building code. In New South Wales, 58 high-rise residential buildings with aluminium cladding are also under investigation.

As a result of these sweeping audits, legal reforms are being introduced that are putting pressure on builders and owners, reports law firm Gilchrist Connell, an insurance specialist. In New South Wales, for instance, new laws empower the government to order rectification work at owners' expense and impose penalties. Further, considerably more onus is placed on owners of clad buildings in other ways, for instance to produce reports confirming the cladding used does not present any risks.

As in the UK, the findings increase the exposure of landlords, owners and other responsible parties to claims and penalties. "Insurers will have seen, and can continue to expect to see, an increase in claims for investigation and representation expenses," warns Gilchrist Connell's report. "There has been a spike in litigation against engineers, architects, builders, surveyors, valuers and certifiers where minimum [building code] standards have not been met."

At the same time, insurance premiums for owners of non-compliant buildings have shot up, with some buildings deemed effectively uninsurable. As a consequence, underwriters in Australia have started to write exclusion clauses relating to combustible cladding. "Brokers will no doubt now arrange more vigilant inspections and investigations of buildings owned by large insureds," predicts the firm.



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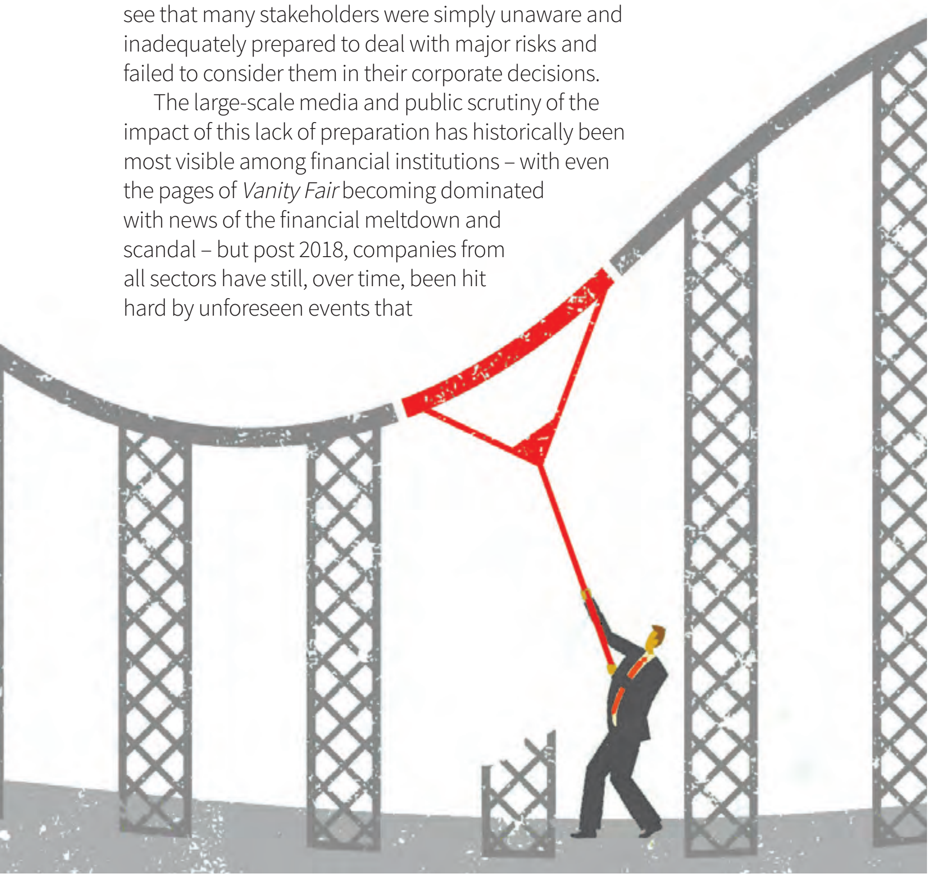
# How do we get derailed?

Economic and corporate crises in our recent history have taught us that solid risk management, communicated effectively to the top, works. Yet often, it never reaches the decision makers.

Much has already been said across the risk management community about the failed resilience of markets, businesses or economies, as a whole, when uncertainty and crisis strike.

At a very basic level of analysis, when you investigate crises such as the 2007/2008 economic crash, the collapse of Enron/Arthur Andersen, or the product recall scandals of the 2000s, to name but a few, you can see that many stakeholders were simply unaware and inadequately prepared to deal with major risks and failed to consider them in their corporate decisions.

The large-scale media and public scrutiny of the impact of this lack of preparation has historically been most visible among financial institutions – with even the pages of *Vanity Fair* becoming dominated with news of the financial meltdown and scandal – but post 2018, companies from all sectors have still, over time, been hit hard by unforeseen events that have resulted in detriment to the company and, at their worst, collapse.



Some of the shortfall in preparedness, and I stress only some, can be explained by the challenge organisations face in being able to respond to 'black swan' events. By their very definition, these types of events must be outliers, beyond the realm of regular expectation, because experience, analysis and existing data cannot point to their occurrence. There is little scope for those wishing to limit the impact of truly black swan events to use any meaningful risk analysis to influence their decision-making upfront.

But if we therefore leave analysis and lessons learnt from such events outside the scope of this discussion, what else can be learnt from previous corporate and economic crises? Can we gain any valuable insight from understanding how risk models failed? Why had the oversight of risk become superficial? What stopped risk management information from being well integrated into a company's decision-making system? Why did they stop listening?

## NOT-SO BLISSFUL IGNORANCE

Despite the huge losses experienced by organisations at the height of any crisis, the majority still survive. They cancel plans, make rapid and painful trade-offs to ensure immediate stability and, as the tide turns, these same companies resume their long-term strategies even if it takes years. And with the benefit of lessons learnt, these organisations should surely now be better prepared for the next shock, whenever it comes.

But how can this be guaranteed? Have there been tangible learnings taken to the heart of the boardroom or will there be continued vulnerabilities that will manifest themselves in the next risk perfect storm?

One of the elements common in corporate crisis is that risk information does not flow freely from the business to the board to provide necessary insight to the decision-making process. Research by Airmic points out that without the right flow of information and without risk information being viewed in the correct decision-making context, things might well be known within an organisation, but not necessarily amongst the decision-making leaders or their proxies.

Problems will therefore flourish, hidden from leaders' line of sight, where decision makers have 'tunnel vision' or live in a 'rose-tinted bubble' unaware of risk factors that would be valuable information for influencing decisions. The 'Roads to Ruin' research studies some strong examples that are indicative of how disregarding the decision-making value of clear risk communication can be disastrous:

"In the cases of Independent Insurance, Enron and AIG, there was poor internal communication about problems because of the hectoring and/or bullying behaviour of the leadership. This blocked internal routes to NEDs becoming aware of what was going on."

"… In the case of the Airbus A380 delays, middle managers kept the problem of non-matching aircraft sections from senior managers for six months. This seems to have resulted, at least in part, from a culture that did not allow the freedom to criticise – essentially a communication problem…"

**"PROBLEMS FLOURISH WHERE DECISION MAKERS HAVE 'TUNNEL VISION' OR LIVE IN A 'ROSE-TINTED BUBBLE' UNAWARE OF RISK FACTORS THAT WOULD BE VALUABLE INFORMATION FOR INFLUENCING DECISIONS."**

### BEING HEARD THROUGH THE NOISE

Why should risk management be important to decision makers anyway? It is generally understood that decision-making (in many settings) is a cognitive process that leads to the selection of a course of action from a set of established alternatives. Published analysis of the business-centric decision-making process reveals a number of stages:

- **DEFINING** the problem
- **GATHERING** information
- **IDENTIFYING AND EVALUATING** alternatives
- **MAKING** the actual decision
- **IMPLEMENTING** the decision
- **FOLLOWING UP** – considering if it 'worked'

However, this is rarely an explicit cycle of activities but iterations 'hidden' within other management practices undertaken in a decision-making setting. Priorities for senior management are stretched, with executive decision makers encouraged to embrace innovation and entrepreneurial development. In many cases, year on year, they are required to pursue challenging strategic objectives and with this expectation comes the implicit obligation to be diligent on the organisation's decisions, and both source and utilise the right information.

Finding this right information is a constant challenge, made harder when the party typically relied upon to collect, collate and present the information is different to the decision maker and business area.

Pivotal to overcoming this challenge is to provide the decision maker with alternatives and consequences, and rely on some corporately agreed preferences, rules and guidance. The problem is that models on what these preferences, rules and guidance should look like is plentiful. Companies don't have to search far to obtain a lot of advice on how to make good decisions or find guidance on what decision-making disciplines actually make a difference. Then add to that all the other noise that has the potential to strongly influence decision-making judgements.

So how do you distil all this noise – these messages and best practices – into something that is manageable and works for you? And through this distilling process, can we identify if risk is really something that could add value?

The results of a McKinsey survey in 2009 provides some comfort here, by categorising all these 'noisy' parts of the decision-making information mix into three analytical aims that emphasise that examining risk information should play a crucial role in decision-making analysis:

- **LOOK AHEAD**
- **PAY ATTENTION** to the risks, examined through a detailed model of the decision at hand
- **KNOW WHAT YOU CONTROL.** Accept that, unlike external risks that accompany decision making, the analysis, discussion and management of the internal threats lie entirely within the control of the decision maker.

If we overlay information about board oversight found in the Companies Act, which emphasises the director's duty to regard the likely consequences of any decision, we complete the circle of why organisations must ensure their company's risk capabilities deliver quality insight into a decision-making setting.

### HOW DID WE NOT SEE IT COMING?

Risk management has long been lauded as a tool that provides clear, transparent information for the running of an organisation. It is there in black and white in the risk management standards old and new (see Clause 3, ISO31000:2009 Principles and Focused Framework in COSO ERM 2017).

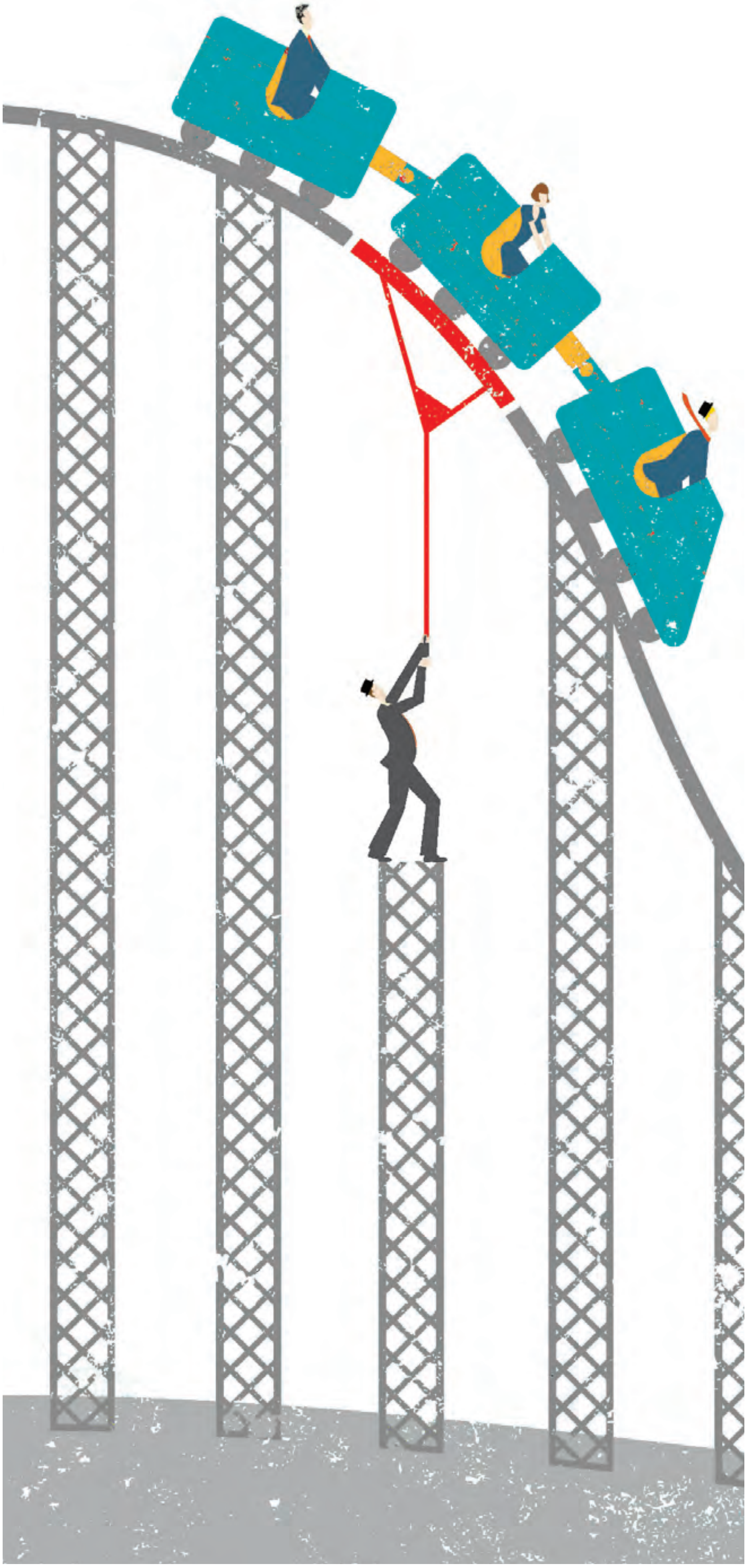
So, if best practice sources agree that risk management is central to corporate success, and if the same sources say risk management is built on

## AUTHOR OF WINNING DISSERTATION

This is an excerpt from Jonathan Blackhurst's winning dissertation, produced as part of Airmic's inaugural risk Leadership Programme 2017-18.

Blackhurst is head of risk management at Capita. He is responsible for creating and implementing risk management for Capita Plc, where he has worked since 2013. Prior to Capita, Jonathan spent seven years leading enterprise risk at Visa Europe, where he provided leadership and advice on risk identification, assessment and mitigation.

To see a different side to Blackhurst, turn to Headspace on page 36.



the principles of transparency and clarity that are equally as vital in decision-making, why is there still this level of variation, debate and uncertainty?

A survey conducted by Harvard Business Review in 2013 points us towards some of the reasons the statements above still don't guarantee risk management engagement during the decision-making process at the top of any organisation.

Accepting this is data nearly five years old, it is still worth noting that, at that point in time, 42% of 442 global executives didn't have confidence in the decisions being made, due to both the lack of access to/availability of data to inform decision-making and the questionable quality of the information.

What this research challenges businesses to address is the need for up-to-date, honest, accurate and relevant data available in real time, backed up by clear analysis at a level that can easily be shared among peers and colleagues in order for them to collaborate on decision-making and instil confidence in the decisions being made.

But surely, once again, the outcome of this research is nothing new. Hasn't this been the claim from risk practitioners for some time?

Another brief look back to the financial crisis of 2008/2009 and economic conditions since shows us that many companies had (and well before the crisis) risk identification processes in place. Often reported as strong and robust frameworks, they have been used across businesses to ensure the risks facing the company are identified, consolidated and prioritised, and to demonstrate transparency and preparedness. Once a year in company annual reports, organisations generate analysis that lists their key risks and looks to demonstrate how this analysis was fed through to the top of the organisation from the internal process of qualitative and quantitative assessment of the probability and impact of each risk.

So why then did these risk processes not raise relevant alarms to management in the lead-up to the financial crisis? Why were these processes not really delivering information to support how an organisation understands its business and makes strategic decisions suited to protecting the business? I suggest a number of reasons:

- **NO BIG PICTURE** Despite trying to focus on principle risks, the bottom-up nature of assessment misses the company-wide risks, with those reporting not seeing the bigger picture.
- **WRONG FOCUS** These assessments do not look to the business drivers, reasons and strategies that have led to these risks.
- **RISKS AFFECT EACH OTHER** These assessments fail to consider how multiple risks co-exist and multiply.
- **RISK REGISTERS DON'T DO ENOUGH** These assessments are too focused on risk registers.

As a result, these processes failed to generate the insight the decision makers could act upon. **SR**

# Change of course

## Will a redirection of our basic principles of risk management add the value we need?

In introducing ISO 31000 in 2009 and enhancing the standard in 2018, the International Organization for Standardization (ISO) intended to provide a guide for the design, implementation and maintenance of risk management. But it is my claim that it is this precise type of systematic and logical process, designed to lead organisations through identifying, analysing and evaluating risk, that is flawed. To this end, below I propose alternative interpretations of the steps set out by ISO 31000 (and most other risk framework processes).

My suggested rethink of the principles is not intended to prescribe specific risk practices, but to offer a redirection for using the risk process to improve the substance of available decision-making information.

**'BOTTOM-UP' CONTEXT CAN ONLY INFLUENCE DECISION-MAKING IF IT IS DOVETAILED INTO A STRATEGIC TOP-DOWN CONTEXT THAT GOES BEYOND SENIOR MANAGEMENT LIP SERVICE.**

## PRINCIPLE 1: ESTABLISHING SCOPE, CONTEXT, CRITERIA

## THINK STRATEGY

Use risk management to advance dialogue around strategy. A winning corporate strategy is one that can exploit areas the organisation excels at relevant to its competitors. Risk management must therefore serve as a guidepost for when a new opportunity or significant risk emerges.

Dialogue around this often turns to the phrase 'risk appetite', but this falls back into the trap of a risk language not necessarily aligned to a strategic conversation. The better focus should be on executive management and the board agreeing on the strategic, operational and financial parameters and drivers around their opportunity-seeking behaviour – all in 'business', not in risk, language. The resulting risk conversation (whether it is called risk appetite or not) then becomes a strategic level reminder of the thresholds in the strategy-setting process. The context of risk management is therefore realigned in order to call attention to the level of risk the organisation is facing, directly corresponding to the decisions it is making in pursuit of value creation.

Continue the focus on strategy, but add line of sight to the external environment. A valuable decision-making approach via risk management should be designed to provide insights as to whether executive management's assumptions about markets, customers, competition, technology, regulations and other external factors remain valid. Dialogue about risk management should be on whether changes in these external environmental factors are expected and whether they could alter the fundamentals underlying the business strategy – in short, a highly valuable early warning capability.

Reinvigorate focus on critical and emerging risks. Most companies will be operating the list and classification of risk around the operational success of an organisation, looking to provide valuable assurance that exposures can be tracked and, over time, resolved. In this context, any sort of debate about risk can be positive, because at the very least, it gets the conversation out in the open.

However, for risk management to add value in a core decision-making setting, the focus needs to be on the areas that will impact the core decision-making setting. The critical risks represent the exposures that can threaten the strategy, business model and the viability of the business, and should consequently warrant the most attention from decision makers.

Senior management also need to be mindful of emerging trends triggered by unanticipated events of varying significance, ranging from catastrophic new events to existing risks accelerating in their impact.

### CONTEXT IS KEY TO UNDERSTANDING

If we accept the redefining of the first principle, what does the change look like? How do we join the dots with coherence and calibration across the business? Many examples of risk context are built from the bottom up, with each business unit naming and classifying things in its own context. Centrally, this will usually be aggregated into something that will claim to resemble a company-wide context, in which risks that report to be of the same type will be forced into an aggregated statement.

But in reality, as business units may not be using the same language, the ease of visualising the real risk context to the organisation at a corporate decision-making level is severely reduced as things can be missed or misunderstood. This can lead to risks being considered in the abstract, and not collectively, with links between them overlooked, leading to a business failing to recognise consistent and endemic points of weakness.

Honest, intelligent, informed contextualisation is also a challenge. As different risk contexts are calibrated from within the operational level of an organisation, how do decision makers successfully set some perspective? The need to develop a consistent and transparent context across seemingly different risks from widely different business areas is a challenge requiring significant insight into the day-to-day operating of the business.

So is this really the best approach to contextualising risk in a decision-making setting, when there are so many moving parts and when it is reliant on a perfect alignment of several facets of analysis? In my view, it is half the answer, and the other half is the part that is vital for establishing decision-making value. Such 'bottom-up' contextualisation can only influence decision-making if it is dovetailed into a strategic top-down context that goes beyond senior management lip service – the priority for 'establishing the context' must therefore be top down.

The building blocks for changing the focus of risk context to top down include:

**SPEAK UP Establish risk context through dialogue amongst the senior management team.** Creating this risk dialogue needs to be as simple as the corporate structure allows, with nothing more sophisticated than ensuring dedicated time in regular executive meetings. What is key is ensuring time is given front and centre to avoid the dialogue being crowded out by other corporate discussion points.

**BE HONEST Top-down risk context needs to focus on actionable debate.** This is not the place to provide executive management with assurance that material risks are under control. The goal needs to be to set the context around the 'what actions do we need to take' debate already in place amongst senior management as they run the business.

**ALLOW FOR RISK Top-down risk context needs an indicative understanding of the level of risk an organisation can afford to live with,** without getting too engrossed in a cottage industry around risk appetite/threshold/tolerances. Ideally, this needs to be contextualised around areas of strategy where the organisation believes it has a competitive advantage, e.g. emerging technology risk where the company has strong R&D credentials.

## PRINCIPLES 2,3,4: RISK ASSESSMENT

# BE PREPARED, BE BRAVE

Follow the full path of impact assessment. When it comes to assessing risk, it is easy for organisations to just look at the high-level impacts and sensitivities (high level in terms of amount of detail). This is insufficient to add value in decision-making and therefore needs a rethink. Risk assessment in this context needs to consider not just the short-term business-as-usual conditions affected by such things as market changes, but also the affect these have on the overarching strategic drivers in the company.

Tell the whole story. The bottom-up risk context focuses assessment on the likelihood/frequency/probability of a potential risk and its impact. This is important. But it should not be the whole story for the decision-making process to fully embrace in seeking value from risk information. It's also key to answer how ready is the company to respond to the risk if it occurs, and how far ahead can the company forecast the risk event coming. These two concepts of preparedness and lead time are vital in order to turn the assessment of risk into a tool that supports decision-making.

Be brave and address ongoing business management risks on an outlier basis. Every business will face a myriad of operational risks (technology, financial, service delivery, HR, security and so on) and most of the effort and resource around assessment are focused on these. The point is that the focus on these day-to-day risks is not the right one when it comes to decision-making. This area of assessment and board communication should not be at the heart of a company's risk methodology, but instead, things should be highlighted only by the escalation of unusual indicators (such as exceeding an established staff attrition limit).

## PRINCIPLE 5: RISK TREATMENT

# DON'T FOCUS ON THE OBVIOUS

Focus risk treatment on the strategic big assumptions. As mentioned, the risks identified as high priority as a result of bottom-up assessment are not, in my opinion, the most valuable to a decision-making context. They are often self-evident, along the lines of 'if a major supply disruption occurred, unfortunate things will follow in our own service delivery'. Focusing risk treatment on this obvious information only further undermines the decision-making value of risk information, because management treatment of these risks is seen as rubber stamping what is already known.

A far more useful exercise for supporting decision makers is for risk treatment to play out the full scenario of the big strategic assumptions that the company depends upon. These risk-based scenarios are the conceivable descriptions of the future and are built so that decision makers can embrace uncertainty.

Instead of reducing risk treatment to a single most likely outcome, these big assumption scenarios attempt to identify the major forces driving external change and the key uncertainties that lead to a wide range of possible outcomes. The parameters and boundaries of our uncertainties are mapped out and provide a risk-based context for treatment and evaluating future strategic options.

While this approach is not designed to implicitly remove hard decisions around risk treatment, and it certainly won't prevent risk from crystallising, it does mean that decision makers can use the risk process with a broader understanding of the risk and rewards. **SR**

# To be or not to be Jonathan Blackhurst?

The head of risk management at Capita enjoys rowing, fencing and, what else, long walks on the beach – especially when there is a lobster dinner at the end of it.

### WHAT ARE YOU THINKING ABOUT RIGHT NOW?

Having taken on the Men's captaincy at my rowing club, I am wondering if enough people will turn up for our weekend outings on the Thames and how many thermal layers will I need.

### WHAT'S YOUR GREATEST FEAR?

I look at the exploding, increasing volatility in the world and the naval-gazing desire to break the global spirit of collaboration – and ask myself, are we done yet?

### WHAT'S YOUR MOST EMBARRASSING MOMENT?

Having drifted from daydreaming into a nap during a GCSE English class, I was woken by the class reading aloud with my name substituted into the narrative… To be Jonathan Blackhurst or not to be Jonathan Blackhurst…

### WHAT MAKES YOU HAPPY?

Walking with my wife and dog on a deserted Cornish beach… and knowing the dinner reservation for lobster and a bottle of sparkling Albariño in our favourite restaurant is already sorted.

### WHAT'S THE WORST JOB YOU'VE EVER DONE?

While at school I qualified to be a pool lifeguard. Unfortunately the Baywatch glamour did not really transfer to being on a humid poolside for hours, with the constant smell of chlorine and cleaning toilets after a very long day. I did get my own whistle though, so every cloud.

### WHAT'S THE BIGGEST RISK YOU'VE EVER TAKEN?

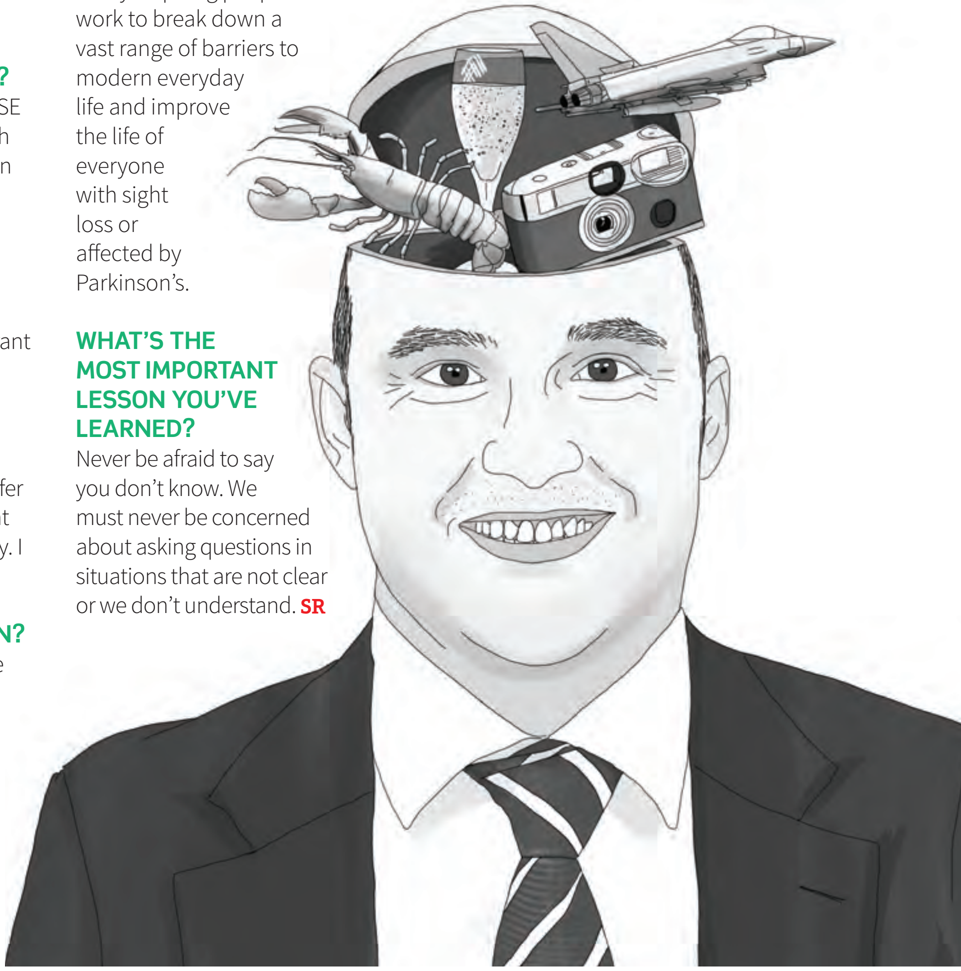
As a sponsored RAF Cadet Officer through university, the day eventually came for my first solo flight. What can possibly go wrong with something as simple as take off, fly in a circuit and land? Well, I trusted my training, the technology at my fingertips and relied on pure bloody-mindedness not to crash. I even managed to keep my nerves under control enough to take some disposable camera selfies mid-flight (as was tradition).

### WHAT IS YOUR GREATEST ACHIEVEMENT?

Reaching an international standard as a fencer, and now that I am considered a veteran, continuing that success by captaining England Veterans to a clean sweep victory in the 2018 Four Nations Matches.

### WHO DO YOU LOOK UP TO?

As an independent member of the risk committees at the Royal National Institute of Blind People and Parkinson's UK, I am surrounded by so many inspiring people who work to break down a vast range of barriers to modern everyday life and improve the life of everyone with sight loss or affected by Parkinson's.



### WHAT'S THE MOST IMPORTANT LESSON YOU'VE LEARNED?

Never be afraid to say you don't know. We must never be concerned about asking questions in situations that are not clear or we don't understand. **SR**

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