The winds of change

This Year’s Risk Frontiers Survey took place at a dramatic time in Europe as politicians all over the continent were dashing about trying to work out what to do about Greece, the Arab Spring seemed to have been re-ignited with dark overtones in Syria and news began to filter through that China and Brazil may not, after all, save the rest of the world from a terminal economic decline. On the flip side, during the same summer Facebook launched a stock listing for a staggering amount of apparently scarce money, Spain won the European Championships again and reminded us all how football should really be played and the Olympics was a roaring success in London without bankrupting the city and causing the catastrophic meltdown of transport and telecommunications that so many had predicted. It was well risk-managed.

As I travelled to and from roundtables in Zurich, Vienna and Milan I also took the opportunity to attend the St Gallen Symposium where world political, business and social leaders met to discuss the future of the planet and risk management was the theme.

It should come as no surprise to any Commercial Risk Europe readers that risk management was selected as the theme for such an event because it has become a very trendy topic. What may come as something of a surprise, however, was the fact that, while leaders from the insurance industry such as Walther Kiellohz of Swiss Re and Nikolauls Von Bombhard of Munich Re shared the stage with the big wigs there were no risk managers in attendance.

This is perhaps a reflection of the fact that, to the wider corporate, economic, academic and political world, risk management is actually carried out by CEOs, CFOs and other board members, not people that carry the job title risk manager and manage insurance too.

One has to also assume that, apart from the fact that Swiss Re sponsored the event, the leaders who attend this annual event actually think insurance matters and is an essential element of risk management, otherwise Mr Kiellohz and Mr Von Bombhard would not have been there on stage along with the politicians and business leaders.

The absence of the missing link—the actual risk manager—from this gathering may in part explain why we spent so much time during this year’s survey talking about macro risks, wider business risk management and the evolving role of the risk manager.

When we turned to insurance the Risk Frontiers discussions this year focused very much on innovation and the problem of how to deal with emerging and primarily non-physical damage-led risks, just the kind of risks discussed at St Gallen, and not the likely direction of rates at renewal time.

What this all suggests to me is that it really is time for the risk and insurance management community to collectively work out where it fits into all of this and whether or not it is going to play an important role in helping business work out how to manage its way through the fast-evolving risk landscape or just watch and react from the sidelines.

This is why industry associations matter and why I believe a survey such as this is important. We put a huge amount of work into this project to ensure that it presents a truly Europe-wide body of expert opinion that could be distilled into a number of key conclusions.

Such work helps individuals see the bigger picture as they drown in the daily morass imposed by ever-escalating corporate deadlines and pressure and I hope that it is as useful to our readers as it was enjoyable to carry it out.

The national roundtables and interviews were published in full throughout the late spring and summer months in the pages of CRE and so this final report contains the highlights and key points as I perceived them. To draw your own conclusions go to www.commercialriskeurope.com and look under the roundtables tab.

Finally, I would like to thank the national risk management associations across Europe which helped organise the meetings and our project sponsors XL Group and Willis for their support in this project without which it would not be possible to carry out. The value of CRE is its editorial independence without which we would soon lose our value to the readers. Thanks to XL Group and Willis for their mature and ‘hands off’ support that enables us to maintain that critical integrity.

And, as ever, I would really value your feedback about this report so that we can make sure that next year’s is even better. Enjoy the read.

Adrian Ladbury, spoke to Mike McGavick, CEO of XL Group

Interview—From the sponsor: Willis

Best Foot Forward: CRE Editor, Adrian Ladbury, heard from Adam Garrad, CEO of Willis Continental Europe

Addendum—Participants

With Our Thanks: Commercial Risk Europe would like to extend its thanks to all this year’s participants.

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Risk community at a crossroads

His year’s Risk Frontiers Survey took place as European companies grappled with big and fast developing political, social and economic changes such as the eurozone crisis, ongoing dramatic effects of the Arab Spring and the spectre of a ‘double dip’ European and global downturn. It was no surprise therefore that this year, more than in the past, the discussion was very macro-focused. The overall impression was that the European risk and insurance management community finds itself at a crossroads. It can head east and turn itself into a fully-fledged member of the professional, board level, corporate team. It can head west and focus on core established competencies and try to help coordinate a more joined-up enterprise-wide approach to risk. Another option would be to trudge on directly north, head down, and hope it all works itself out. And finally the community could justifiably just turn around, head back south, hunker down back into the pure insurance space and let everyone else sort out the mess. This year’s survey suggests that the most likely direction currently is north-west. The other big conclusion is that the insurance industry needs to take a very long and hard look at what role it could and should play in this space. Europe’s risk and insurance managers will find it very difficult to take advantage of the current situation and the higher profile enjoyed by the profession if the insurers are unwilling or unable to rise to the challenge and fail to deliver the kind of innovative solutions that the modern, increasingly service-led economy needs. Following is a synopsis of the key conclusions reached from this year’s roundtables and individual interviews based on the key questions asked.
Q1. What are the big risks and what keeps your board members awake at night?

The biggest business risks faced by companies in today's economic environment according to this year's participants in the Risk Frontiers survey are overwhelmingly macro business risks.

Board members are worried about big things like the level of interest rates, volatile currency markets, fast-changing regulation, political risk and how to deal with torpid domestic demand and the challenge of tapping growth in far-flung markets.

Europe's risk and insurance managers are being dragged into this big risk picture and it is a real challenge because it is very different from the comparatively cosy world of insurable risk management.

But the simple fact is that structured and enterprise-wide risk management is more important than ever before as Europe's corporations attempt to fight their way out of recession.

Big strategic decisions are being made at all levels and it is clear that the risk and insurance management community has a potentially big role to play to help ensure that the right decisions are made at the right time.

Q2. How could and should the corporate risk and insurance management profession respond to this evolving landscape?

Risk and insurance managers all over Europe are being invited to meetings they were never invited to before to discuss topics they never believed they would have a part in debating and seeking solutions for.

They are also in communication with the main board and are expected to come up with solutions, and fast.

To rise to this challenge Europe's risk and insurance management community needs to determine exactly what its members' role should be within an organisation, how they should work with other 'departments' and deliver the goods that the board is looking for.

This is not an easy task because the harsh spotlight brought upon the profession in recent times makes it clearer than ever before that no two risk/insurance managers are the same.

“Globalisation of business again presents risk and insurance managers with an opportunity to prove their value to the organisation that was not available in the past...”

Q3. What are the challenges for risk managers raised by globalisation?

It is eminently logical to expand to high growth markets when your core markets have literally stumbled to a halt.

But, even when under intense investor pressure, such rapid expansion can bring all kinds of unexpected risks, as proven by the supply chain problems caused by the catastrophic events in Japan and Thailand last year.

The survey suggested that Europe's risk and insurance managers are really struggling with such risks and it seems that board members need to think long and hard about the risks attached to such expansion, hopefully before they leap into them and not as an afterthought.

The globalisation of business again presents risk and insurance managers with an opportunity to prove their value to the organisation that was not available in the past. But this is a complex and fast-changing environment riddled with risks and challenges that are outside of any company's control. For risk and insurance managers to play a fully proactive role and help properly risk-manage their expansion they need to be involved from the beginning and this is clearly still not always the case.

Q4. Global Programmes

International insurance programmes was again a hot topic during this year's survey and, given the fact that so many European companies are seeking growth outside of their core markets, this should come as no surprise.

Risk and insurance managers are expected to deliver cost-effective insurance coverage within all the territories in which their company operates.

The obvious solution is for the risk manager to team up with brokers and insurers that have genuine global networks and build coherent, consistent and compliant programmes that can be easily managed from the centre.

But, as has been discussed at length in the pages of Commercial Risk Europe over the last couple of years and was again covered during this year's survey, to achieve this is just not as easy as it sounds.

There is still a huge level of uncertainty about the true compliance of international programmes, particularly when they include risks in fast-developing
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nations such as Brazil, China, India and even in more mature insurance markets such as the US and Canada.

Political pressure on fiscal authorities to deliver more revenue for cash-strapped governments and protect local insurance industries really does not help the multinational risk and insurance manager.

There was a high level of support among this year’s Risk Frontiers participants for the global database of insurance rules led by Airmic and Ferma. But most recognise that this is merely the first step in a long, complicated and arduous journey.

Q5. Innovation and the evolving insurable risk landscape

Innovation was a big topic of discussion in last year’s survey and perhaps even more so this year.

The headlines in CRE and the wider press over the last 12 months have been dominated by hot topics such as supply chain and BI, cyber and reputational risk, all of which can be defined as emerging, or at least fast-developing, risks that demand rapid solutions.

Many of the participants in this year’s survey accept that it is not easy for insurers to come up with broad-based and cost-effective solutions for their changing risk profiles overnight. They understand that the insurers need to analyse the data properly and spend time with their customers before they can put their investors’ capital at risk.

But the European risk and insurance management community is clearly not happy with the pace of change and willingness of the insurers to take a risk in what should be areas of potentially rich growth for them.

There also appears to be rising frustration shown by many risk managers with the blinkered approach of the insurance industry as it struggles to cope with risks that do not fit into its traditional business models or lines of business.

And there is a concern that the brokers and insurers do not have a deep enough pool of talent to tackle difficult areas that do not rely on good old physical damage to trigger the policy.

The world is changing and many of the risk managers who took part in this year’s survey are not convinced that the insurance industry is willing and able to change fast enough with it. The logical conclusion reached by a rising number of risk and insurance managers in Europe is that they will simply have to seek alternatives as traditional risk transfer inevitably becomes less relevant.

The gauntlet is there and is waiting to be picked up!

Q6. Insurance market conditions

There was relatively little vigorous debate about the state of the market and outlook for terms and conditions during this year’s roundtables and individual interviews.

The reason for this seemed quite clear: the soft, or at least flat, market continues and, despite the pressure exerted on the insurers by last year’s catastrophes, low investment returns and interest rates, there is still little sign of a hardening in Europe.

The market remains very competitive and if one insurer finally decides to stand firm it seems that the customer has no problem finding alternative quotes, still often at a big discount, elsewhere with reputable alternative insurers.

AIG aside, the leading insurers and reinsurers of European corporate risks generally rode out the credit crisis and coped with the chain of catastrophes experienced in recent times better than ever. Solvency II does not look like it will become the great game-changer that was originally feared by some.

Assuming normal catastrophe levels over the next couple of years, the biggest threat to insurance market stability would appear to be reserves. The insurers and reinsurers have benefited hugely from reserve releases over the last few years and this well is finally running dry.

None of the risk and insurance managers who took part in this year’s survey seem to be worried about a sudden reverse in the trend that will require huge reserve additions such as those seen in 2002–2004 and which led to the dramatic fall of companies like Converium.

But logic suggests that dwindling reserves could well be the straw that finally breaks the camel’s back and forces a turn in the market. For now though, Europe’s risk managers seem perfectly happy with the level of capacity and prices on offer for their more standard lines.
CHAPTER ONE—THE BIG RISKS

THE BIG RISKS
Technology lies at the root of all

Technology lies at the root of all

This year’s survey found that Europe’s risk managers appear to be grappling with an even wider array of subtly interlinked and interdependent risks than last year. No coherent and consistent list of top three, five or ten risks could be produced for this reason. The current volatility and uncertainty that dominates the global economic, financial and political system makes it very difficult to categorise risks in the traditional way and therefore come up with neat standalone solutions. But, while it is difficult to generalise about the overall risk landscape, it does seem fairly easy to identify the cause of all this uncertainty: the pace of change. What seems clear from this year’s survey is that the speed and scale of change in all guises means that strategic decision-making, not least in risk management, is more difficult than in the past. The one unifying factor that seems to drive these unprecedented levels of uncertainty and this relentless pace of change is information technology.
think that they could never mess it all up, despite the obvious warning signs provided by the collapse of Long-Term Capital Management.

So if there is one common driver that underlies all of the big risks identified by the risk managers who took part in this year’s Risk Frontiers survey, and which keeps their board members awake at night, it is information technology, its use and of course its abuse, both intentionally and unintentionally.

The problem is not with information technology per se. On the whole technology and quick and easy communication is a good thing. The problem for risk and all other managers is the speed of change and the uncertainty it generates.

The overall impression gleaned from this year’s roundtables is that risk managers are currently in danger of acting rather like rabbits frozen and staring at car headlights just before they are crushed into the tarmac.

The pace of change is difficult for corporations to cope with using the established systems of risk identification, measurement, management and transfer.

The rapid globalisation of European business as it desperately seeks to compensate for sluggish domestic growth is a good example of this.

Technology makes it possible to seek new markets, and resources, to build supply chains that look as if they apparently work perfectly when viewed in real time on a monitor, in a neat matrix, back at headquarters.

But when the wind blows too hard and it rains too much these neat supply and distribution chains that looked so effective on screen tend to fall apart. And this is exacerbated on an immense scale because everyone else is doing the same thing and unfortunately all are tied together in a complex interdependent chain.

Technology has therefore speeded up the pace of competition, shortened the window of competitive advantage and thus arguably forces companies to make rash decisions that have not been properly thought through from a risk management perspective.

This means that many risk managers feel that they are faced with more uncertainty than ever before and uncertainty is not a good thing for a risk manager.

If there is one overriding conclusion to be drawn from this year’s list of big risks then it is summed up neatly in the following old phrase: ‘Look before you leap’. The trick is, of course, how to persuade everyone else to slow down, take stock and think again.

The following are the big risks identified by the risk and insurance managers who took part in this year’s survey and which led to the above conclusions.

♦ Big Risk 1—The crisis that would not go away

The continued impact of the financial crisis is the start point of the big risks identified by this year’s group of risk managers. This is logical, because the majority of the risk managers who took part in this year’s survey work for companies that seek growth in fresh markets to compensate for poor domestic demand and to do this, apart from ongoing business needs, they generally need credit.

The ongoing eurozone crisis and the inability of the politicians and technocrats to find a solution has exacerbated this problem many times over because it has effectively bunged up the credit supply line, particularly for companies based in southern Europe.

Risk managers from the less dramatically impacted central and northern European countries were marginally more relaxed than their peers in Spain, Portugal and Italy during the roundtables.

But even the Germans, who on the whole have enjoyed a relatively good crisis, are fearful of the medium to longer-term impact of frozen finances and the longer-term ripple effect on demand.

If nothing else, the big risk is the inability to take advantage of opportunities that may not re-emerge.

—Allen Lima, CRO at EDP, the Portuguese electricity provider: “Because of our high growth rate debt has grown quite quickly and it is not a good moment to go to the market to refinance. The [credit] rating of Portugal is very low, and as healthy as we may be, rating agencies will not give us a rating that is more than one notch above that of the Portuguese Republic. This creates several difficulties. Some of them have been overcome with the arrival of new Chinese shareholders, but finding funding and obtaining good conditions to refinance the debt remains a problem.”

—Gregor Köhler, CEO and President of Pallas Versicherung, the insurance arm of German pharmaceuticals and chemicals giant Bayer: “[The eurozone crisis] poses a serious threat for companies in Europe and even worldwide. Currently, Germany holds an exceptionally comfortable position, but it will not be able to keep it forever, if there is no real solution forthcoming...National health systems are being squeezed by the financial pressure of the crisis. Countries like Greece, for instance, are having major difficulties in finding the money for pharmaceutical products and there have been severe cuts in national health budgets. The most frustrating thing is that companies can do very little about it.”

—Gaëtan Lefèvre, President of Belrim and Group Risk and Insurance Manager at engineering group CMI: “Clearly cash is king. We are active in project management in industrial engineering and it is important to have a cash curve positive to be able to finance the ongoing projects and to develop the business. Therefore cash is really important and in the case of claims, efficient payment from insurance is so important currently.”

♦ Big Risk 2—Sickly demand & intense competition

When credit runs dry, companies find it more difficult to chase growth opportunities and inevitably the reaction
is to cut prices and costs at the same time in an effort to maintain margin. The impact of this can be rapid and have a very sudden effect on underlying demand for all.

This downward spiral of intense competition for a dwindling share of the overall cake, accompanied by cost and inevitably job cuts, means that companies have to be particularly careful about how they manage their cash and must choose their suppliers carefully. This means that the risk manager needs to act increasingly as a business continuity and credit manager.

Another big risk introduced by the volatile economic and financial environment that risk managers seem to be increasingly involved with is the need to help deal with the spiraling price of raw materials and currency fluctuations that can have a dramatic impact on the risk profile of the business.

The job of the risk manager is made all the more difficult because economic and financial downturns, particularly sharp ones, tend to be accompanied by a regulatory reaction that is all too often politically motivated, knee-jerk and not really that helpful for anyone.

—François Malan, Director of Risk Management at property group Nexity in France: “We have to look into our supplier risks. Today, we know our companies, we are familiar with our own financial reports, but we do not know much about our suppliers. They may be bust, and we are not aware of it. So, as risk managers, we have to focus on this risk in a recession period. We need to be sure that they are going to provide us with the products and services we need, or to have options ready to replace them in case they are unable to do the job.”

—Yvon Colleu, AMRAE Treasurer and Risk and Insurance Director at industrial group Bouygues: “Our group works in the construction sector, and the crisis affects important clients for us in the public and private sectors, both in terms of Capex budget and financing capacity. It is clear then that it has an impact on the revenues and the activity level of the group. As a result, the group as a whole needs to mobilise itself to face the possibility of a reduction of business activity.”

—Edwin Meyer, General Manager, Risk and Insurance at steel and mining company ArcelorMittal: “Nothing fundamental has changed in the economic landscape. There have been changes to currency valuations, prices of raw materials and reserves particularly when dealing with countries such as Brazil and South Africa which can be challenging when linked to currency fluctuations and cause exchange risk and the like.”

—Victor Vereshchagin, President of RusRisk in Russia: “We do not have enough qualified workers and engineers. The outlook is that in five to eight years some companies may have to close down because of this development. In addition, the best educated people, academics and engineers are emigrating to the US, Germany and so on.”

—Nikolai Ivanov, Risk Manager at gold producer Polyus: “We mainly deal with social risks—risks connected to the lack of qualified employees. What we especially need is well-trained staff. But gold production is spread all over the country. Some of the metals you can only find in the far east of Russia and Siberia. So we have a lack of qualified workers that are prepared and willing to work in these regions.”

—Catherine Van Cauwelaert, Director-Head of Group Insurance Management at Euroclear, Belgium: “People and operational risks are also important in our business, and we take measures to minimise them as well. For example, we are in the process of opening an office in Poland to alleviate the potential difficulty of attracting the right talent in Belgium.”

Big Risk 4—Excess pressure on costs

In a tough market, the obvious way to reduce costs is to tighten stock levels, cut staff, often by attempting to outsource more administrative functions, and make existing people work harder.

This approach places a significant strain on remaining workers at all levels and can lead to labour disputes, supply chain interruptions and have an immediate impact on the quality of the product which, in turn, can affect reputation quite quickly and sometimes with catastrophic consequences.

This strain caused by tightening of budgets clearly presents risk managers, who themselves are under tight cost control, with a variety of risks to try and deal with...
and, once again based on this survey, is clearly raising the pressure levels within Europe’s leading companies.

One risk area that surprisingly only one individual brought up was the increased stress levels placed upon individuals in this low cost, pressure cooker environment.

One can only assume that risk managers will wake up to the fact that they will have to work with HR to cope with fast-rising levels of stress-related problems in the near future as the pressure of working harder, faster and for longer hours coupled with the inability to escape work because of modern technology and communications will take its toll.

—David Howells, Director Group Risk Management & Insurance at food processing and packaging firm Tetra Laval: “What we are looking at now is not trying to impose fixed growth targets but rather achieving sustainable growth. We are more concerned about building sustainable growth for the long term. One big risk is provided by the activity of competitors, some of whom are only competing on price. We are trying to get our heads around the current market consensus. Do customers want the lowest price or value for money? We are worried about the potential impact price competition may have on the future quality of the product.”

—Klaus Grothe, Risk Manager with Andritz, the plant engineering group: “There is more pressure on people and the balance between relaxation and work is more difficult to manage. I appreciate the position taken by VW to shut its email down between Friday and Monday. But this is an exception. At the first and second management level it seems an accepted philosophy that you do work over the weekend but you don’t send messages until Monday morning.”

◊ Big Risk 5—Rapid and uncontrolled expansion

The vast majority of this year’s survey participants said that one key way that their companies are trying to trade their way out of the downturn is through expansion to new growth markets.

In the past European companies tended to venture into so-called emerging markets in search of cheap production options based on cheap labour or easier access to raw materials.

Now the emphasis has shifted to expansion to the emerging markets, particularly the BRICS countries (Brazil, Russia, India, China and South Africa), in search of sales as much as production. This brings a whole host of new risks to consider, not least supply chain risk which is of course exacerbated by the fact that these growth markets tend to be prone to more catastrophic losses.

The fact that this latest wave of expansion has been driven by need rather than desire has also meant that it has been rushed.

The sense derived from this year’s survey is that many of Europe’s risk managers are somewhat bewildered by the new range of risks that they face back at headquarters in London, Frankfurt or Madrid and that, all too often, the decisions have been taken without full consideration of the risks involved.

Technology has again played its role in this expansion of the risk horizon. It is all too easy for corporate headquarters to assume all is under control in the new territories because they can be communicated with immediately and numbers and assurances can fly back and forth with ease on the web.

But there is a definite sense among the participants in this year’s survey that many companies are perhaps fooling themselves that they have a greater degree of control and management over their risks in far-flung territories than they really have. The overall conclusion is that some back to basics risk management is needed sooner rather than later.

—Maurizio Castelli, Managing Director, XL Group Italy and former Pirelli risk manager and president of Ferma: “This is for sure a risky combination, and Italian companies, which are not used to facing this situation, need to address these risks carefully. In fact, expansion into these markets and a less balanced geographical spread not only bring political risks but also questions about how sustainable and solid these markets are as a base for moving forward.”

—Daniel San Millán, Risk Manager at construction and concessions group Ferrovial and President of Igrea: “Then there are all the risks related to the internationalisation of our businesses. Sometimes companies do not know much about the country into which they are expanding, its local culture and ways of doing business. The crisis is providing us with an incentive to go abroad and in the case of Ferrovial only 10% of our EBITDA comes from Spain. But this generates lots of risks. The only viable way to manage such risks, in my view, is to implement an effective enterprise risk management programme. It must ensure that the managers of the business are able to anticipate risks in each situation and country, and then be able to come forward with solutions.”

—Mário Ramírez, Head of Insurance and Risks at logistics group CLH: “Another risk is the lack of sources for growth of our business. That is the reason why we have to go abroad. At CLH we are making an effort to internationalise our activities. We are launching into foreign markets as it is clear that here in Spain growth is complicated. We have been working on internationalisation plans over the last few years, but events, such as those that occurred in Argentina or Bolivia [where the government expropriated assets] do not build trust amongst our shareholders towards certain countries.”

◊ Big Risk 6—Political, regulatory & social uncertainty

Another major risk that risk managers face currently is simply the uncertainty brought about by political and regulatory change.
The politicians and regulators are under as much pressure as the companies to find solutions to the economic and financial problems that everyone is struggling to cope with.

This can, and does, lead to inconsistent rule and law-making that can change without warning and significantly raise the compliance and reputational risk faced by risk managers.

It can also lead to extreme decision-making both at home and abroad, which again only adds to the uncertainty and stress for all.

—Paolo Rubini, Risk Manager Telecom Italia and President of Anra, the Italian risk management association: “Yes we are still in an economic downturn and certainly not at the end, but in the middle, of the crisis all across Europe and this is certainly creating a new social and political environment. We had local elections last week which saw a big protest vote and a new internet-based political movement led by a comedian did well. This was a pure protest vote.”

—Bruno Dunoyer de Ségonzac, Head of Risk Management and Audit at Bouygues Télécom, France: “All companies face competition risk, with the additional problem that it can also be exacerbated by regulation. Many governments have been eager to intervene in the economy of their countries. They try to regulate markets, sometimes with good intentions, but they often end up creating dramas at the level of companies. In this context, risk managers must highlight the risk and give a value to it. Risk managers stand out when they are able to attribute a cost to a risk.”

—Jorge Luzzi, Group Risk Management Director with Pirelli Worldwide, Italy, and President of Ferma: “We saw this situation whereby Spain’s Repsol lost its stake in oil major YPF to the Argentine government. Also the Bolivian government recently expropriated the assets of Spain’s Red Electrica. Both governments argued more or less the same points as justification for these actions. They said that it was a lack of investment in the local subsidiary because at headquarter level the companies were trying to contain costs and reduce these actions. They said that it was a lack of investment in the local subsidiary because at headquarter level the companies were trying to contain costs and reduce these actions. They said that it was a lack of investment in the local subsidiary because at headquarter level the companies were trying to contain costs and reduce these actions. They said that it was a lack of investment in the local subsidiary because at headquarter level the companies were trying to contain costs and reduce these actions. They said that it was a lack of investment in the local subsidiary because at headquarter level the companies were trying to contain costs and reduce these actions. They said that it was a lack of investment in the local subsidiary because at headquarter level the companies were trying to contain costs and reduce these actions.

—Martin Heiss of A1 Telekom, Austria: “Twenty to thirty years ago you were managing separate economies. If a company is doing something wrong, such as in the cyber risk space, this will nowadays pop up immediately. If you think of the social market, 20 years ago it was much smaller and therefore easier to communicate with and manage. Everyone today uses Twitter and scandals emerge very quickly so people get very nervous and if you don’t have the answer the newspaper will. You have to ask yourself, are you exposed by your supply chain and will you be affected?”

—Julia Graham, Chief Risk Officer at law firm DLA Piper: “Catastrophic failure of IT infrastructure is a big risk. We’ve seen recently that businesses cannot take their eye off the basics like this. There is a temptation in tough financial times to cut support and maintenance of the infrastructure of a business. This can be a short-term fix with long-term consequences. Boring to some, but basic stuff.”

—Nicola Harvey, Risk Manager at UK-based international auction house Christie’s: “In the art industry, as in most other industries, protecting
client information is critical. Is this a new thing? No. But things change as you expand globally and grow the business. We have been embedding a new global strategy since December and you have to manage cultural and behavioural change as a key part of that, emphasising risk awareness and the need for compliance across the group.”

—Olivier Mournal, Vice President Risk Management at Belgacom, the Belgian telecommunications company: “The key is that technology changes very rapidly. We have moved rapidly from a hardware to a software world. We have the cloud, social media and the entertainment industry which all is more than pure hardware.”

Big Risk 8—Decision-making paralysis
All this uncertainty—economic, financial, cross-border, cyber—poses one big fat managerial risk: The risk of not being able to make a decision because the environment changes so fast and the facts are simply not available in time.

Risk and risk management has flown up the corporate agenda in recent times because of the financial crisis and all its consequences, and managers in all disciplines are all too aware of the need to respect risk and make proper risk-based decisions.

But this year’s Risk Frontiers survey strongly suggested that all business managers, including risk managers themselves, are also under intense pressure to make quick decisions to help drag their company back on track and fight their way out of the current malaise to emerge stronger, fitter and ready to take full advantage of the hoped-for upturn.

Many of the risk managers who took part in this year’s survey are more than aware of the implications of this delicate and dangerous corporate combination, particularly as the operating environment—political, social, economic and technological—changes so fast. The next big question is: Are Europe’s risk and insurance managers up for the challenge?

—Nikolai Ivanov, Risk Manager at Polyus, Russia’s biggest gold producer: “We have to think about production plans, finances, the economy, stock problems. In the long term, we need to consider other things, which are often difficult to predict exactly. Currently, it is very hard to assess the future of the euro. We cannot say what we can do in the long term. Should we invest in the euro, for example in eurozone companies? Should we buy them or not? Or should we wait, because they may be available in a year’s time at half the price?”

—Paul Taylor, Director of Risk Assurance at Morgan Crucible and now an independent consultant: “You have to focus on strategic opportunities and to do this you absolutely have to develop opportunities ahead of the competition and this means continuing with research and development. The problem is that investors are risk averse as well as the banks and so a really proactive approach is needed that is helped if you have built up a good track record of delivering in the past. Good risk management is part of that.”

—Ian Thomson, Vice President Risk Management Centre of Excellence at UK-based pharmaceuticals company GSK: “The effectiveness of change and project management programmes is a fundamental risk when you are pushing for growth while at the same time driving operational efficiency initiatives and trying to return cash to shareholders. Sequentially they are straightforward to manage. Parallel delivery is an altogether different challenge demanding retraining, new skill sets and a conscious shift in business behaviours in order to succeed.”
THE EVOLVING PROFESSION

Decision time

It has presented the European corporate risk and insurance management community with a rare opportunity to raise its profile and significance in the wider corporate world. But this opportunity carries with it many risks that need to be identified, analysed and managed before the individual takes the leap. This year’s survey found participants in thoughtful mood at this exciting moment in the history of the profession.

When asked about the big risks that face companies currently and what keeps their board members awake at night, the risk managers who took part in this year’s survey gave a remarkably wide and subtly interdependent group of risks.

What was interesting was that none of them fell into the traditional insurable risk categories. These were all macro business risks that traditionally fall outside of the remit of the insurable risk manager and somewhere inbetween their world and the wider world of treasury, audit, compliance and ultimately the CEO.

Ten years ago one would have predicted that, financial and economic circumstances aside, this would have been a natural and inevitable development that justified the rise of the chief risk officer as a valid and powerful board member to whom the insurable risk manager probably reports.

But the fact is that the day of the Cro has not arrived despite the fact that the circumstances that theoretically demanded its rise have occurred.

This means that the incumbent managers of risk—insurable or otherwise—who still generally have very varied job titles, descriptions and functions, have to face up to the fact that they have to manage many of the risks that the Cro is supposed to manage.

This occurs whether they hold the job title or not and to shoulder the wider brief will not necessarily mean that the risk manager is granted a huge new budget.

This year’s survey confirmed that it was the dramatic onslaught of the credit crisis and subsequent economic downturn that created a demand for more efficient and effective management of corporate risk.

The rapid expansion of European companies to emerging markets in Latin America, Asia, Africa and the Middle East in search of new revenues to bolster flagging domestic revenues has also added to the increased demand for risk management services, or at least to the workload borne by the risk managers.

As many of the participants in this year’s survey wryly pointed out, this expansion was invariably carried out without taking the full range of risks into account beforehand.

But, despite this unfortunate fact, existing risk and insurance managers still have to deal with the risks, whether they are ready, willing and able or not.

This confluence of external events that have inadvertently raised the profile of the risk management discipline has given risk and insurance managers the chance to grasp the golden chalice and raise the profile and significance of the profession. But, of course, this year’s survey confirmed that this opportunity also carries great dangers along with it.

Risk is by its nature an unpredictable thing and the recent events in Japan and Thailand have underlined once again how much more difficult it has become to accurately identify, measure, manage and transfer these evolving risks.

This means that individuals who carry the job title of risk and/or insurance manager face a highly unpredictable career opportunity and threat at the same time.

On the basis of this year’s survey it seems that the
problem for many risk managers is that, having spent most of their careers in search of certainty in a sea of uncertainty, they are now being asked to grasp a highly fluid and dangerous opportunity and control it.

Most of those European risk managers who took part in this year's survey clearly have spotted the opportunity offered by the crisis to them personally.

But most of them also clearly appreciate that this is a chalice that could well be poisoned.

Very few risk managers would openly admit that the prospect of widening their brief beyond the safe old insurable world to encompass the broader business risk environment is actually a very scary prospect.

The simple fact is that those who stick their heads above the parapet tend to find that it gets shot off, particularly if it is done rashly in response to fast-changing circumstances.

To avoid such nasty surprises, risk and insurance managers clearly need three conditions to be met.

First, they need direct and explicit board level support for an expansion of the brief so that, if nothing else, progress is not hampered by other ‘competing’ disciplines such as internal audit.

Second, they need the right management skills to help them make a success of the wider brief. No company is going to grant the risk manager a massive new budget with hundreds of staff spread across the group to hands-on manage the risks. This has to be carefully and skilfully coordinated and delegated.

And third, the risk manager actually has to want to make the change and this should not be taken for granted.

Risk management has leapt up the boardroom agenda…

✧ Sabine Desantoine, ING BeLux

“"There is more awareness of the risks and the recent financial crisis was essential in building this awareness. It is essential for the board to know the context of a crisis, who they need to communicate with and how. Risk is at the board level far more than five years ago.”

Therefore risk and insurance managers increasingly report to and communicate with the main board…

✧ Malou Gossez, AGC Glass, Belgium

“"In our company, risk management now reports directly to the CEO...by using ERM properly you can see the potential impact and context far more easily. This is vital. A few years ago our CRO reported to the CFO but now he has also direct access to the audit committee representing the board. They listen to what risk management is saying which is obviously a good thing.”

But they need to be bold and brave…

✧ Creighton Twiggs,
Clariant International, Switzerland

“"Mindful that directors and senior managers are usually highly experienced it is important not to report to them the obvious. The value of ERM is to assess and quantify threats and opportunities...Risk management therefore really needs to be an independent audit of the targets that are derived for the strategy, it is not an accounting process or property value identification but a collation of business views. As a result it can be highly subjective and risk managers really should be encouraged to ask questions...In the end, whatever industry you operate in you have to find the gaps and be critical and be prepared to raise hell if need be. If the risk management process is just information and opinion collection using forms then very quickly it becomes stale and irrelevant.”

✧ Philippe Guerry,
MF Risk Services, Switzerland

“"You have to ask to what extent cost cuts are affecting safety for example and you have to be prepared to step in if necessary. If you don’t feel able to speak freely, transparently and openly you cannot do your job properly.”

And be prepared to tell it as it is…

✧ David Howells,
Tetra Laval International, Switzerland:

“"Are we talking about burying your head in the sand or managing communication? Is there a fear of revolt? I don’t think that generally speaking people are ignoring and editing out risks but there is a perception problem in that people do not want to show any weakness and may not be prepared to tell it as it really is.”
CHAPTER TWO—THE EVOLVING PROFESSION

The old categories are dead…

Paolo Rubini, Telecom Italia & President of ANRA:

"The risk is there and can never be got rid of but it can be managed and transferred more effectively. We are not talking about the old categories of insurance here. To think like that is dangerous because it may lead to less investment in traditional loss prevention because this is regarded as something that you don’t have to worry about anymore. But this is a problem because, as a risk manager, you have built your profession on this and you could become more isolated and weaker as a result."

Which means teamwork is more essential than ever…

Jorge Luzzi, Pirelli & President of Ferma:

"At the end of the day nobody is an expert in all areas. Nobody could play all instruments in one band and play well in all positions in a soccer team."

And for that you need the right skills and experience…

Tjerk Van Dijk, Stork/Fokker, Netherlands:

"I think the difficulty for companies is finding people that have some general experience in a wider range of roles. Young people cannot start as a risk manager, you need to understand a company and have some life experience. When you ask people why they are in the industry, 99% of the time it is a coincidence. Nobody wakes up one day and says: ‘I want to be an insurance manager!’ But I think if you ask those working in the role, most will say they have the best job in the company."

But also education, particularly for non executive directors…

Paul Taylor, independent risk management consultant:

"They need to really understand risk management and get it. One of the problems is that these people are very busy and so need clear simple presentations and the right kind of information to absorb. The book that Airmic has just published with the Institute of Directors is a starting point. To learn something new, most people need some training. And of course companies should have people on the board who can have risk management knowledge, if not risk managers themselves."

The profession needs credible qualifications…

Paul Taylor:

"Other professionals such as chartered accountants, lawyers and company secretaries all have recognised standards and qualifications but the risk manager does not even have a globally recognised definition. We recognise some of our own professional education like IRM, CII but few others do outside of our discipline and so for us the challenge is to build up recognition and credibility of the profession in the wider business world."

And the word needs to be spread to a wider audience…

Nicholas Bailey, BBA Aviation & Chairman of Airmic:

"An effort to spread good practice and awareness through the technical agenda and Airmic’s work with other bodies such as the CBI, ACT and IOD will help enhance risk awareness and the value of the profession more generally."

Which is why the educational challenge is a big opportunity…

Gilbert Canameras, Eramet & President of AMRAE:

"Companies demand from risk managers that we work in a more precise way, and that we map the risks related to the crisis. We cannot simply paint a picture of the risks the company is exposed to. We have to define plans to mitigate them, to identify the owners of the risks...The crisis has evidently triggered a trend at companies to reduce costs. It affects everybody, risks managers included. It is necessary to be capable of adapting the means we have to the needs of our companies. But even in a situation of crisis, risks can be turned into opportunities."
Any effort to try and pull together a robust, consistent and compliant cross-border risk management and transfer programme for the risks of globalisation will inevitably not be easy.

But this year’s Risk Frontiers survey found that these risks are simply unavoidable.

The fact is that European companies need to expand abroad currently because of sluggish domestic demand and near-negative GDP levels.

So in this year’s survey we asked the participants what exactly are the key risks that this new wave of global expansion generates and how could and should the risk managers deal with them?

Following is a summary of the response and advice given to the wider risk management community provided by this year’s participants:

1. Watch out for rash expansion

The pressure of the financial and economic crisis has clearly led to some rash decisions made by sales directors who had not read their risk manager’s handbook and in particular the section that contains the old phrase: ‘Act in haste, repent at leisure’.

Nicholas Bailey, Group Risk Manager with BBA Aviation and current Chairman of Airmic, works for a company that has a strong business in the US.

He pointed out that there are all sorts of cultural and regulatory issues that risk managers need to look out for when their company expands.

“Bribery and corruption are tricky areas because they are closely and seriously regulated in the UK and US now but are not such a big focus for governments in places like Asia and Russia where people seek to expand. So there are pitfalls when you are growing rapidly and your local people are very excited about the opportunities without properly assessing the corruption exposures,” he said.

Joint ventures are one way of breaking into new markets but there are risks associated with that approach because the partners may not really understand each other’s business and this can lead to ‘real’ problems, said Mr Bailey.

A second and rather more detailed look at the cost benefit equation may make some rethink their big ideas and focus on more familiar markets, he suggested.

“You need to consider the risks. There are opportunities in Asia but for us there is still potential in the US. Therefore you don’t necessarily have to risk all by breaking into new markets but can seek to maximise existing markets and opportunities,” he said.

2. Supply chain becomes stretched and complex

Allen Lima, CRO at EDP, the Portuguese electricity provider, said that consumption of electricity has fallen in Portugal and that the group’s growth has come from its international activities.

Some 60% of EDP’s profit now comes from markets outside of Portugal and the strategy of the group is to grow in markets with better potential for growth, especially in emerging markets in Latin American and the Far East.

But for this reason supply chain risks have become a big concern for EDP as for so many other expanding European companies.

Mr Lima pointed out that EDP has invested a lot of money in renewable energies, in wind energy, and, in Brazil, in hydroelectric power plants.

But he said that the growth of wind energies creates ‘complex’ supply chain challenges. He said, for example, that it is necessary to find places where it is attractive, from an economic point of view, to produce electricity.

But, in some cases, environmental impact assessments will block such locations for energy production. The
CHAPTER THREE—THE CHALLENGES OF GLOBALISATION

acquisition of the required licences can be difficult and the group also has to purchase generators so that they will be available in time.

This forces the group to build a portfolio of possible locations, which creates more costs. “This is especially problematical in the US, where nobody moves without being paid up front. Such a situation requires detailed management of the entire supply chain,” explained Mr Lima.

“Additionally, once licences have been granted and works can begin we hire contractors to build the plants. Managing this process is complex too. Some wind energy plants are set up with project finance and in such cases banks are terribly demanding. Any delays can mean a huge loss of money,” he continued.

As a result, in addition to construction insurance and the other coverages that are usually taken for such projects, EDP has to buy protection for loss of revenue in case of delays, said Mr Lima.

José Luis Amorim, Risk Manager at Sonae Group, the retail group, said that it had already identified supply chain as a major risk.

“Dependence is certainly higher at the international level. In products like textiles and electronics the number of available suppliers has shrunk. To solve this problem we have tried to diversify so that we are not too dependent on a single provider. In any case, we continue to transfer some risks to the insurance market, such as those related to the transportation of merchandise,” he explained.

Marco Terzago, Corporate Property Risk/Insurance Manager South Europe & Asia at bearings, lubricants and engineering group SKF Industrie, said that he had originally thought that the most exposed products were those in Europe.

But he has now concluded that it is actually the products that are sourced in the emerging countries that are the problem, and confirmed that cheaper sources of production are not always an irrelevant concern in today’s global economy.

“Manufacturers need to produce in these markets because their customers and suppliers may be there and also labour is cheaper, it may be lower quality, but this is a cost issue. Therefore you need some components and they may be produced in emerging markets,” explained Mr Terzago.

“But there are very, very few countries where you have the chance to meet the suppliers. Most of the time the problem is with transportation. We source steel rings in India and have options in South Africa or Korea. So if something happens to a ship we have a problem,” he explained.

3. Process and IT can’t be ignored

Sales managers often leave a trail of immediate political, legal and cultural problems for others to sort out when they sign a big deal in a new territory.

But in today’s IT-dependent world one of the most seriously overlooked risks presented by rapid growth is the ability of the existing IT infrastructure to support and enable that growth.

Sabrina Hartusch, Global Head of Insurance at Triumph International, the global lingerie company, said that, in her view, the challenges presented by IT legacy systems are just as important as getting the supply chain under control.

“We are coming from a decentralised and more local world to a more centralised and partly regional global world and you have to set up your systems and people accordingly. So for risk managers I think it is less about risk identification and more about getting the operational teams on stream,” she said.

4. Political & regulatory change can be sudden, dramatic & unexpected

Nadezhda Nosova, Risk Manager at Sistema in Russia, said that her company is involved in India and the main challenges there are political risks and legislation.

“We are there with our telecommunications business. We are facing some risks right now. They have mainly to do with the laws and the political climate. Sometimes you run the business according to those principals and laws, and then the processes change dramatically,” said Ms Nosova.

“Even if you keep track of risks and you understand the changed legislation or the new regulation that might be introduced, you still do not fully understand the severity of the impact which these changes may cause to your business. You cannot rely on the political stability of the country,” she continued.

Another big political risk to consider is the potential for the sudden and unexpected loss of valuable government contracts.

Marco Terzago at SKF said that it is not unusual for a company to enter a new territory because it has one very important customer and that may well be the government.

“They may be a good payer but the risk remains very high. For example one may be interested in setting up a greenfield site in Asia for big bearings or windmills. The lead time may be 36 months from setup to delivery. The market may have been growing double digit numbers for the last 10 years, then it all stops because a new government comes in and reduces the incentives for renewable energy and you are dropped. Likewise you may invest in projects for high-speed trains across Russia, but will it happen?” said Mr Terzago.

5. Protectionism & the social agenda

Pure political risks such as the recent rise of protectionism and expropriation of assets is an altogether different type of risk to ‘normal’ political risks such as those outlined above and are incredibly difficult to predict, measure and manage with any certainty, let alone transfer.
“If we go buying companies in other parts of the world, we need to understand that local countries are now very demanding with external investments. They like to see that the multinational will contribute to the local economy and that part of the money will stay in that country...”

Jorge Luzzi, Pirelli

Mr Amorim at Sonae in Portugal explained that all companies which operate in emerging countries should today have opposite worries to those that beset them only two decades ago.

“Back then Brazil and China demanded reciprocity from Europe, so that the global market could evolve. Today we see them creating mechanisms to protect their own industry, and this will have an impact on world trade,” said Mr Amorim.

Jorge Luzzi of Pirelli and Ferma has a deep knowledge of the Latin American markets and is fully aware of the risks.

“If we go buying companies in other parts of the world, we need to understand that local countries are now very demanding with external investments. They like to see that the multinational will contribute to the local economy and that part of the money will stay in that country. If we analyse the new giants such as the Brics countries (Brazil, Russia, India, China and South Africa) they are seeking to consolidate their position and Russia appears to be a new quick-developing, free market with a lot of potential,” said Mr Luzzi.

Spanish companies have perhaps been hardest hit in recent times by asset-hungry governments in the emerging nations of Latin America.

Marta Segura, Corporate Insurance Director at Prosegur, the global security company, pointed out that political risks have always been a factor but added that the risk model has changed somewhat recently.

“Some political leaders will hint to a company that if it wants to be allowed to carry out its activities properly it needs to hire more workers. Or that it should sponsor some kind of aid programme for a deprived segment of the population. So in your business plan you are forced to make some adjustments because of political risks,” she explained.

“As Spanish companies have no options but to expand abroad we have to identify the cultural barriers that we can meet in foreign markets even before we get there. We must also be careful with reputation risk, which is something that can compromise the whole investment. Companies need to arrive in new markets understanding the basic pillars of the business environment and then gradually adapt risk management models to what happens,” she added.

Mr Luzzi said that this problem was overtly evident in the case of Spanish oil company Repsol which lost its stake in oil major YPF to the Argentine government. The Bolivian government also recently expropriated the assets of Spain’s Red Electrica, he continued.

“Both governments argued more or less the same points as justification for these actions. They said that it was a lack of investment in the local subsidiary because at headquarters level the companies were trying to contain costs and reduce investments outside the country of origin. We will encounter more difficulties like that and it is necessary to pay a lot of attention to this trend of political risk,” said Mr Luzzi.

6. Compliance & the bumpy playing field
Compliance is a hot topic in the risk and insurance business for all the wrong reasons but also of course in the wider global trading environment as competition is so intense.

One risk that is largely glossed over in public but is a real issue in private is the added cost of competing with local companies that do not seem to have to adhere to the same rules as international players.

Speaking on a more generic level, Alessandro De Felice, Group Risk Manager, Finance, Administration, Control & IT at Prysmian Group, producer of high-technology cables and systems for the energy and telecommunications sectors in Italy, said that it is simply a strategic risk to be compliant simply because the costs can be so high.

“You have control processes and audits for the type of strategic risks that are largely controlled by listed companies in Europe and the US. This is a huge cost and if companies are taking this cost they are basically at a competitive disadvantage and in my experience large companies are not willing to cut compliance anywhere because they want to maintain an integrated system,” he said.

7. Don’t forget it’s a different culture
It seems obvious to assume that all companies that expand into new, far-flung territories do not try to impose their way of doing things back home ‘over there’.

But unfortunately for those left to clear up the mess after the wrong decisions have been taken this appears to be still too often the case.

Daniel San Millán, Risk Manager at construction and concessions group Ferrovial and President of Igera, said that cultural ignorance is still too common.

“One thing that has become clear to me in all the years we’ve been working with foreign markets is that Spanish
companies cannot go abroad and expect things to work the way we are used to. It is a common mistake,” he said.

“The truth is that each country has its own ways. We have to adapt ourselves to their ways of doing business even though we may believe that we are more efficient or that we do things better. Companies need to be flexible and get rid of their prejudices,” continued Mr San Millán.

Igor Mikhailov, Head of Risk at Mobile TeleSystems, the Russian telecommunications company, said that typically his company expands into new markets via mergers and acquisitions and so culture is very important.

“Cross-cultural risks must be taken very seriously, not only between countries but also between corporate cultures. The new company must be integrated. However, our real ‘attention-getter’ is operational risk—how to manage the company as an acquisition. How to make it work in the global company,” he added.

8. Look out for those hidden legal & tax problems

As any manager of an international insurance programme will testify, to expand into new territories and seek to manage and transfer risk inevitably means that you discover legal and fiscal problems you did not imagine existed. The bottom line is to dig deep and take proper advice before you take the leap.

Nikolai Ivanov, Risk Manager at gold producer Polyus, gave advice to fellow risk managers based on harsh experience.

He said that Polyus had decided to merge with a gold company based in Kazakhstan which looked great on paper but soon after the deal was done it encountered serious problems.

“There are certain regulations that restrict us from moving the production out of the country, and that stipulate that we need to employ local staff rather than our own staff,” he said.

“At the end of the day we realised that that deal was not profitable for us. We want to expand, we want to become one of the top five gold producers in the world. One of the ways to do this is to invest in other producers; however, the deal was not good for us. Now we have to withdraw from the contracts,” he explained.

Mr Ivanov said that one of the reasons for the problems was that the documentation it received was neither clear nor verified. “The geological and financial documents were incomplete. Even the documents that were presented to the shareholders were misleading. They even presented these to the London Stock Exchange. And when all contracts were signed and we had completed the deal we discovered that everything was not as rosy as it had appeared in the documents,” he explained.

9. Lack of talent… again

The battle for talent is by no means restricted to Europe and in many ways is significantly more intense in growth markets as demand outstrips supply by some margin for talented and knowledgeable staff to make new operations work as planned.

Rudi Casteeels, Client & Distribution Leader Benelux Region for XL Group, said that this is an ‘enormous’ topic that should never be underestimated when considering the risks associated with global expansion.

“If you are a European company you are inevitably established abroad and you have to hire local people and there is a real war for talent going on currently. Good people move on easily and so your investment in people can disappear very quickly and you have to know how to react,” he said.

Malou Gossez, Risk Manager at glass manufacturer AGC Glass Europe, also in Belgium, agreed. “In emerging countries, you have to expect that good young people will stay for two to three years and then leave your company,” she said.

10. Don’t overdo the control

Risk managers are of course trained to look out for and highlight potential problems. That is why other managers in the group will often automatically groan when they see them enter the meeting room.

But, as leading corporate risk managers never tire of pointing out, good risk management is also about helping the business to spot and properly analyse the opportunities. Remember there is also a reward side to the risk-reward equation.

In this sense, the Belgian risk managers sought to remind peers that, while discipline and control is very important when venturing into new markets, risk managers must remember not to take it too far and stifle the creativity out of the venture.

Sonia Cambier, Risk Manager with Solvay, the international chemicals and plastics group, said: “It is nice to be valued. A desire to have controls everywhere and processes is positive but it can also be dangerous because it can lead to a culture of paralysis.”

“Generally speaking if you go to a business and ask how the risk is managed you will get an answer from an internal auditor because it is policy. It is very, very important to get information and people do tend to be afraid to move information to the top, especially if it’s negative. It is important to understand what the board needs to know but it can be a danger,” added Ms Cambier.

Olivier Mounal, Vice President Risk Management at telecommunications firm Belgacom Group International Services, agreed. “Too much control could kill entrepreneurship,” he said.
EUROPE’S RISK MANAGERS ARE BECOMING increasingly frustrated about the apparent inability of their core risk transfer partners to overcome local regulatory and fiscal problems in emerging markets and help them find robust solutions to their ever more complex international risk transfer needs.

This year’s survey found rising levels of exasperation among Europe’s risk and insurance managers about the absence of answers to the difficult questions as they seek to manage and transfer their global exposures.

The customers understand that the local insurance supervisors and tax offices in the territories into which they are expanding are all too often vague, driven by protectionism and at times self-contradictory.

This, the insurance buyers concede, makes it difficult for the insurers and brokers to provide neat and easy solutions to their problems.

Lack of consensus
But, at the same time, the risk and insurance managers find it perplexing that the insurers and brokers often do not even seem to be able to agree internally what the rules mean and what needs to be done about them, let alone find the basis for a market consensus.

This is presumably why there appears to be market-wide support building for the Airmic and Ferma initiative to create a global database of rules that is accessible to all risk managers to try and build a foundation of commonly accepted knowledge, even if many individual risk managers remain sceptical about its chances of success.

But before delving into what needs to be done to fix the problems with international coverages it is, however, worth reviewing why demand for the service has risen so much in recent times.

The risk managers who took part in this year’s Risk Frontiers survey concluded that cross-border coverages and global programmes have become so much more important because European and international companies are so desperate to expand to fresh markets and bolster revenues and profits. In the process fundamental risks are often overlooked.

Playing ‘catch up’
This leaves the risk manager in a position where they have to play catch up all too often and their risk transfer partners are too often unable to meet their needs in the time required.

Inevitably the growth markets that European and international companies are keen to target are the most complex and challenging. This is because so often the local regulators are trying to protect the local insurance market while at the same time generate foreign tax and other revenues, apart from the broader challenges of working in maturing markets.

And the rules that can complicate efforts to create seamless and cost-effective international insurance programmes are not just national protectionist efforts. Regional and international trade rules can also cause headaches when trying to put together the perfect solution.

Add to this the problems caused by sanctions that
are imposed by international bodies such as the EC and the complications they can cause for insurance coverage, and the challenges that face today’s multinational risk managers are crystal clear.

So what are the insurers and brokers doing to try and meet the evolving demands of their customers, remove some of the frustrations and provide the level of comfort that their multinational customers so evidently desire?

It is an irrefutable fact that the big international insurers and those regional insurers with aspirations to win and support the big ticket multinational accounts have put a lot of time, effort and money into trying to meet their customers’ needs in this complex area in recent times.

But, according to the risk managers who took part in this year’s survey, unfortunately there is much more that needs to be done.

A number of survey participants pointed out that for the standard exposures such as property and liability in a cross-border environment, it is fairly easy to control and manage international exposures.

But, once a risk manager encounters the more complicated exposures, such as motor or aviation liability, they often find that their broker’s network is not always able to provide the guidance or information needed and communication becomes tricky.

It seems that quite simply multinationals must face the fact that the footprint of the global programme does not match the footprint of the broker or other service suppliers and, even if it does, not all local offices are able to deliver the same level of service that is expected at headquarters.

One of the problems picked up by the risk managers during the Swiss roundtable in Zurich is localism and the innate desire to protect your home turf, a tendency that is equally applicable to risk managers, brokers and insurers.

Global means local

It is a simple fact that, even in today’s sophisticated global world, if a company wants to set up a new global programme built on local policies their risk/insurance manager feels they have to work with global brokers that can help them fight for control.

It was pointed out that the ultimate goal is to surely have local best practice for local wordings. But when a centralised programme is adopted with an integrated approach the risk manager has to make sure that the insurer issues the coverage in accordance with local needs.

But the fact is that the insurer will generally tend to push for local coverage that does not provide broader coverage than the master. And the insurer will also try to keep limits locally at a low level because the total exposed limit could increase to a higher limit than expected for the whole programme because local legislation may not consider an aggregation of limits.

Generally speaking, DIC and DIL structures do not apply in many countries therefore the local programme policies need to be robust enough to adequately cover the local risks.

This is all very sensible and informative stuff.

But the basic question remains: Is the response from the insurers and brokers good enough? The answer sadly all too often in this year’s survey was: ‘No. Could do better’.

So what is the solution?

One solution, perhaps the only one that is not really a sales effort poorly dressed up as a wider philanthropic contribution to the corporate wheel, is the attempt by Airmic and Ferma, along with the London International Insurance Brokers’ Association (LIIBA), to create a global database on insurance rules to at least provide a solid and consistent base to work from.

Thankfully progress was reported on this effort during the Risk Frontiers interviews at the Airmic conference in Liverpool. The project now has the backing of three of the biggest brokers, and this has been well-received by risk and insurance managers across Europe.

Database delivery

This ground-up database effort is a laudable attempt by the risk management community to find a solution to a big problem in the absence of acceptable solutions from elsewhere.

The insurers, brokers and other experts have to support the initiative if only because they risk upsetting their customers if they refuse to play ball.

Many risk managers believe that the insurers and brokers quite like the confusion caused by the patchwork quilt of global insurance and fiscal rules that apply to global programmes.

It is assumed by many that this mess justifies their fees and commissions and generates extra (paid) work for all who feed off the risk transfer chain.

It is perhaps for this reason alone that it is surely incumbent upon the regulators themselves to actually take this area seriously and work together on a regional and international level to help out the very policyholders that they are designed to protect.

To date, we have neither seen nor heard anything from the regulatory community on the prospects for a more joined-up approach to cross-border insurance regulation and this is a shame.

Commercial Risk Europe will continue to pester the regulatory community for a response and hopefully for next year’s survey we can include a section of interviews with insurance supervisors and provide some revealing answers.

CHAPTER FOUR—MULTINATIONAL RISK TRANSFER

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Let the People Speak

Participants in this year’s Risk Frontiers survey had a lot to say about cross-border coverages and the need for improvements from the insurance market. Following is a selection of the best quotes:

- **Just give us clarity…**
  Nicola Harvey, Christie’s, UK: “I just wish that the insurance industry would get their act together because it is so frustrating that there is disagreement and lack of clarity. The legislation is unclear and the authorities do not give clear answers.”

- **Look before you leap…**
  Nicholas Bailey, BBA Aviation & Airmic, UK: “In some parts of the world you just cannot secure the coverage. You can find that companies go ahead with expansion without any cover and have assets and liabilities in place that are not insured because local management got ahead of themselves before thinking of the liabilities. Therefore trying to grow the business organically is a challenge as it is trying to grow by M&A of course, as anyone who has worked in that environment will attest.”

- **Hidden costs and inadequate limits…**
  Creighton Twiggs, Clariant International, Switzerland: “They tend to be not consistently regulated but highly regulated and there are hidden additional costs to providing consistent insurance in, for example, China or India. In China you need a policy for each canton for example. In these places and Latin America it is difficult to find adequate limits locally and ensure that you have the coverage in place in a compliant way…Excess layers risk creating tax exposures which is an added complication. Local compliance can appear overly-complicated and at odds with group policy.”

- **Beware the tax man, just comply…**
  Nicholas Bailey, BBA Aviation, UK: “[Tax authorities] just want tax dollars and it is a potential opening for more tax revenue. The bottom line is that if you are a global corporation or even only have operations in one or two other territories you have to be as compliant as possible. No one is perfect and the rules are often confusing and unclear but the tax authorities are interested and so you have to do your utmost to be as compliant as possible. The proposed (Airmic/Ferma) database will take us a long way along this journey.”

- **Protectionism is on the rise…**
  David Howells, Tetra Laval, Switzerland: “What is new is the speed at which situations change in different countries, all the time! Developing countries want to protect their fledgling insurance industries.”

- **Brokers need to up their game…**
  Tjerk Van Dijk, Stork/Fokker, Netherlands: “When you get to the more complicated insurable risks it is very difficult to communicate those through the network of the broker.”

- **Risk and insurance managers need to be strong…**
  Eric Bloem, Heineken, Netherlands: “Fight and fight…It is a never-ending story but that is not a reason to complain because that is how the world works. I do not believe that my company’s network is performing 100% across the world.”

- **Global database—is it the solution or at least a start?…**
  Helen Hayden, Prudential, UK: “We have had to spend time working out the model and the structure which is the boring behind the scenes part but fundamental to the success of the project. It has taken us a long time to get to this position but I am confident that we will have something in place to assist risk managers.”
Chapter Five—Innovation

Innovation was a hot topic of debate during this year’s Risk Frontiers roundtable discussions and individual interviews. The insurers and brokers have been told to up their game or lose premium. But a decent proportion of the risk and insurance managers concede that they have to smarten their act up too.

The insurance industry has to work out how to be faster and smarter in its approach to innovation or it will lose out on badly needed premiums in fresh markets, according to this year’s Risk Frontiers participants.

Not only that, as Mike McGavick, CEO of XL Group conceded at the DVS Symposium in Munich this year (please see page 34), the industry is in danger of becoming irrelevant if it fails to keep up with the pace of change in the industries that it serves.

This was a big theme in last year’s survey. But the catastrophic events that hit Japan and Thailand in particular sparked serious questions about supply chain and business interruption risks.

This, on top of fast-rising concerns about cyber risk, has sharpened the focus on the apparent inability of the insurance industry to deliver the kind of risk transfer solutions that insurance managers need in the time required.

And both these risk sets—supply chain and cyber—both lead inexorably to the same result: An inability to deliver goods and service to customers.

This comes at a time when global competition is higher than ever and the potential cost of failure is huge. Thus, both lead directly to a third big uncertainty—reputational risk.

The insurance sector therefore faces both a threat and opportunity of equally huge proportions, as was made clear by this year’s participants.

The opportunity for the individual insurer and broker is obviously to be consistently better at innovation than the pack.

It is a well-known fact that the first mover advantage in insurance is difficult to maintain because any new product is generally so easy to copy.

The subscription system, which is particularly necessary for the higher risk market, makes that first mover advantage even more difficult to maintain and meaningfully benefit from.

But, the evidence from this year’s survey suggests that those insurers and brokers that can consistently deliver more innovative products and services will succeed over time.

The profit made from launching a groundbreaking new product may not last that long as the rest of the market rapidly follows suit.

But loyalty will be gained among important customers if such innovation can be ingrained into the company and consistently delivered.

But, as Mr McGavick pointed out in his speech and subsequent interview, this depends upon efficient and effective information capture and exchange, something that the insurance industry has not been particularly good at in the past and needs to become much better at to avoid becoming irrelevant.

But this information exchange question is riddled with uncertainties and risks itself.

First, risk managers have to do a lot of groundwork themselves to dig out the correct information and this is not necessarily easy in areas like supply chain and cyber in which information ‘owners’ may not be so keen to play ball.

Second, they need to talk to suppliers and internal experts to evaluate that information and make sure that it makes sense. This cannot be underestimated and modelling tools are not readily available yet to do this.

And third, the risk manager then has to work out what he could or should release to the insurer in what can be a sensitive decision that ultimately could mean he or she winds up with more expensive cover anyway!

The discussion on innovation during this year’s survey also broadened out to incorporate a much wider...
range of services that has interesting implications for insurers too.

To deliver a groundbreaking new product that encompasses a wider range of cyber or business interruption risks is one important step. But customers are also looking for a more innovative service in general in key areas such as claims.

The UK risk managers in particular seem to be very interested in this area, perhaps because of the longer-term project on achieving contract certainty in the London market.

It seems that this effort has evolved from the simple delivery of the contract on time to the delivery of a contract that actually works as it was originally intended.

There is therefore quite a focus currently in the UK in particular on pre-claims discussions that involve customer, broker and insurer, and importantly claims people not just customer relationship managers, to thrash out exactly how the contract works and what happens if and when the claim occurs.

The desire for a more efficient and customer-centric approach to the business of corporate insurance was not, however, just limited to the UK and claims.

Once again, risk managers all over Europe expressed dissatisfaction with the overly process-driven and inflexible nature of this market, which seems to be finding it very difficult to drag itself out of the overly structured line of business approach that so obviously restricts the insurers’ ability to innovate, but helps them manage their cost bases.

The good news for the insurers is that many risk managers who took part in this year’s survey appreciate that the insurers, and perhaps to a lesser degree the brokers, do recognise this fundamental problem and are making efforts to fix it.

The following quotes from this year’s roundtable meetings neatly summarise the thoughts and desires of the European risk management community on the highly topical subject of innovation:

**Austria**

**Klaus Grothe, Andritz:**

**Supply chain is tough to manage**

“You can probably track your major components and high value parts. But, at the end of the day, if there is a little screw missing that represents a miniscule part of turnover it can be catastrophic.”

**Insurance process needs a rethink**

“Yes we have problems. The insurance process is not meeting our needs. The cover comes in more and more lines. But we are completely dissatisfied with the approach of the insurers on the topic of sanctions for example. It is not clear what is insured or what is not.”

**Martin Cerny, A1 Telekom:**

**Sell solutions not products**

“Identify where the coverage shortages are. Most insurers try to sell products and that is it. Risk management should identify where the products need to be sold and for what.”
France

François Malan, Nexity:

❖ Don’t try to shoehorn new risks into old models

“Cyber risks are complicated for a risk manager to understand, as they are connected to IT and to new regulations. A few companies offer some coverage for cyber risks, and we have to work with them because we are still trying to understand this risk. They offer cyber risks policies, but they are very often translations of American policies with high deductibles; I do not think they are so far well adapted to the local market.”

❖ Difficult to sell to the board at a high price with no claims

“Premium for this could be high and is an extra cost…When we have to convince our bosses about the need to purchase such insurance, they say it is too expensive especially in this crisis period. It is also hard to convince them why we need it, because the majority of French risk managers haven’t faced claims so far.”

❖ Insurers need to be faster and more proactive

“The insurance market has not been really able to provide the solutions that we need for regulatory risks. They have given us some answers, but not all the answers that we need. Today business units are in a hurry to work, and they need coverage right now. But insurers argue that they need more time to assess what could be the risk, the losses and so on. There are not enough partners of companies in this and they need to be more proactive and offer the coverages that we need in a more efficient way.”

❖ Brokers need to be more proactive

“They know their customers, so they can identify the risks their clients face and work with insurers to develop solutions for them. This has not been really the case. Brokers need to be more proactive.”

Gilbert Canameras, AMRAE & Emaret:

❖ Cover needed faster and with higher capacity

“Insurers have presented some innovations, but not enough…Some solutions to new risks like cybercrime or supply chains have reached the market, but in my view they are products that mostly try to answer [urgent] needs… Insurers offer us new products with a capacity of about €20m, which is not enough…Perhaps such products will develop further, as happened with coverages for environmental risks. But for the moment they remain embryonic.”

Yvon Colleu, Bouygues:

❖ Partial solutions are not good enough but more data needed

“We have over 6 million clients in our telecommunications business and we need to take care of our databases, so cyber risks are reflected in the risk map, and we are open to any insurance solutions for them…At the moment, the solutions offered by the market are only partial ones…Guarantees are limited. It is a field where the response of the market has not been very satisfactory, but it is a situation that changes at a speed difficult to match by insurance markets who like to study historical statistics, so we can understand that insurers have not come with perfect solutions for cyber risks yet.”

❖ Insurers need too much time

“Insurers bide their time to expand coverages to a large extent because of the novelty of the risk. A lack of historical statistics make it hard for them to estimate the risks that they are asked to carry and, in the case of cyber risks, the situation is even more complicated…Cyber risks are linked to market evolutions that are not very logical from a regulatory point of view…When the law changes, the risk changes too, it is an environment that evolves quickly.”

❖ No need to reinvent the wheel, just improve quality of service

“Above all we want quality service standards. We expect insurers and brokers to improve efficiency and reduce costs. Innovation is one element of what they can offer to us, but sometimes clients who need the basic services are provided with higher levels of quality. We want to see clear policies and to pay fair premiums, and we want contractual documentation, premium and losses to be processed efficiently. These are not new things, but they are very important for us.”

Bruno Dunoyer de Ségonzac, Bouygues Télécom:

❖ Insurers try to be more flexible

“I believe that the insurance market has been more open than before to create new products. That is possibly an effect of the crisis. Previously, they had a rigid offer of products and you had to choose from it. But today they are willing to adapt products to the needs of clients. We can have a dialogue, and we have been able to come up to a number of insurance products that have been fully adapted to our needs.”

❖ Brokers have a critical role to play in innovation

“If the broker manages to define the risk with clarity and in a language that insurers can understand then insurance companies can come up with solutions. Very often we struggle to elaborate clear definitions of risks that are strategic to our companies. But brokers can find the terminology to explain to insurers what our real needs are.”
Switzerland

Filipe Gomes, Willis:

◊ Cyber needs teamwork to properly identify and manage the risk

“People who are not working in the IT security department usually have difficulties in understanding these intangible risks that are changing very quickly. Also, the teamwork between operational risk management and IT security has room for improvement. IT people tend to be located in a different department. The process to assess, mitigate and transfer the risk, involve a broker and the insurance industry, is an opportunity to get a better understanding on cyber risks and improve the cooperation between operational risk management and IT security,” he said.

Creighton Twiggs, Clariant International:

◊ Cyber cover does not meet buyer needs currently

“We are trying to get a grip of the big picture and go from there to assess the value of insurance and other risk transfer solutions. For example cyber risk is apparently insurable, there are products available but for me they do not appear to fit our needs,” he said.

David Howells, Tetra Laval:

◊ Real innovation is about delivery not just products

“You can create a class of insurance but if it is not on my list of risks I am not going to buy it. If you have a risk and you need to insure it you have to try and find the cover. If you cannot find the cover then you can go to the capital markets. If it is a pure business or strategic risk then you will probably not be insuring it anyway. The real point is delivery, joining up all the branches worldwide in a consistent manner, with protocols, consistent reporting and the like. This is still innovation in the insurance market!”

Russia

Igor Mikhaylov, Mobile TeleSystems:

◊ Information is BI risks’ pothole

“There is one problem: you need to know all the partners of the partners. Even if your partner is strong, but they require a single piece of equipment from another supplier that is not sustainable, it could become dangerous if the supply chain is not diversified... This is a controversial topic because we’re discussing the core of their business. They want to keep their business and operations secret. However, I think it’s easier for large companies, such as we are, to speak openly and call for greater transparency than it is for smaller companies. Nevertheless, insurers should be more innovative and provide more complex customised offers.”

Mikhail Rogov, RusHydro:

◊ Physical damage is not enough

“Insurance only compensates physical damage and some other costs. For a company like ours such business interruption programmes without compensation for fines and profit losses possibly are not of such interest and are not sufficient.”

Germany

Hanns Martin Schindewolf, Daimler Insurance Services:

◊ The modern economy may simply be too complex for insurers

“Business interruption is very interesting and leads to the question of whether the complexity and dynamics of modern production philosophy can be maintained and the real risk calculated. Is risk management strong enough to change the just in time (JIT) sequence? Can we have duplicate components and products sourced in areas of low natural catastrophe risks? Does the chief operating officer appreciate these risks and appreciate that underwriting is not an exact science or subset of maths but also partly an art that needs companies to provide real data on the supply chain risk to properly assess. But are the carriers able to properly assess and model this risk?”

Klaus Braukmann, Conti Versicherungsdienst:

◊ Companies need to simplify their production and supply processes

“I think that the products themselves need to become less complicated. If you are in the electronics business perhaps do not launch a product until you have developed your own system rather than relying on lots of different providers to assemble it with limited back up.”
Hanns Martin Schindewolf, Daimler:
✓ Risk managers need to be outspoken and aware or face loss of cover

“Some insurers were really not aware of what was covered under their [BI] policies and only now realise they were given the coverage carte blanche. At the end of the day such catastrophe risks are not always faced up to and the task of risk managers is to be outspoken and to be aware. The insurance industry has learned a lot but there is a risk here that the whole market falls apart such as in the pharmaceuticals market. In this sense Solvency II will not help because it will make the industrial risk market less attractive for insurers.”

Alexander Mahnke, Siemens:
✓ Risk and insurance managers are also to blame for lack of innovation

“What we need is an on-going professional discussion among companies, insurers and brokers. I do not agree that the insurance market does not foster enough innovation. It is at least as much up to the insurance risk managers to express their needs and worries, to express what kind of support we need in analysing and potentially transferring our risks. And, of course, we have to be prepared to pay money for newly developed products.”

Jurand Honisch, Bertelsmann:
✓ Providing more information to insurers can backfire with higher prices

“All too often the company that does provide more information is the one that gets hit with higher prices and restricted conditions because they are perceived as more risky because they provided more information. It is not that simple.”

Klaus Greimel, E.ON Risk Consulting:
✓ High competition does not always help with innovation in insurance

“The insurers could adjust their approach to analyse and calculate the risk better but if they are faced with a situation whereby they do not receive enough information to properly analyse the risks then the simple fact is that they know there will be another insurance company out there that will still do it.”

Jurand Honisch, Bertelsmann:
✓ Not clear the insurers have the right people to actually analyse the risks when presented

“Where is the ability, know-how and capacity to work with your information? Where are the skilled, experienced and knowledgeable underwriters? Even if you provide them with the volume and complexity of information that is demanded what are they going to do with it? Sit in a chair and think about it? Where is the analysis of this information and who is able to carry it out?”

Edwin Meyer, ArcelorMittal:
✓ It boils down to price and competition at the end of the day

“It boils down to a question of price, what is the right price for the risk in question and whether the premium is unaccounted for when it covers the risk…I am not responsible for the underwriter’s conclusion but I have to accept it even if the underwriter is not as educated and comes up with a worse result than is actually the case. You have to give the information and accept the result or go elsewhere.”

Jurand Honisch, Bertelsmann:
✓ But it’s unfair to compare new products with existing ones

“I have to defend the position of the insurers to an extent. Whenever they do launch a new product we always tend to compare it to existing products, which is not fair. I would say that the total cost of risk approach is nice and very sophisticated but when insurers launch new products there is inevitably a mismatch between the scope of the coverage and the price and the buyer says no transfer. This is often simply because existing coverage has been offered at such a competitive price for such a long time and the comparison with new coverage is not necessarily fair.

Edwin Meyer, ArcelorMittal:
✓ The risk manager also has to sell the risk

“Let’s not forget that we must invest in innovation ourselves by improving our own ability to sell the risk because there is not always an existing risk portfolio into which it can be easily placed.”

Jurand Honisch, Bertelsmann:
✓ But the market is still light years away from where it needs to be

“If the person responsible for risk transfer has consistently obtained reductions of 1%, 2% or 5% at renewal for a long time then what chance have they of convincing the group to accept a significant increase in insurance cost because of a new product that has enhanced the scope of the overall coverage? We are light years away. Game change is needed.”
Demand for more information on supply chain risks is healthy for all

“There are not many of our suppliers that I would allow our insurer to go to directly to find the information they say they need. But on the other hand it is a good thing because it is giving the risk manager the excuse or impetus to dig into the supply chain. If you work in the pharmaceutical sector then you are probably quite good at it already because it is absolutely essential for that business. But for many risk managers it is a bit of an eye opener when they start talking to people in the company about key suppliers. It could be a small component that could really threaten your business.”

Market needs more time to develop a buyable product for BI

“The insurers are still only treating this as property damage and not non-damage business interruption (NDBI) for which the market has still not found the right coverage. Supply chain or non-damage business interruption demonstrates the innovative nature of the market. But at the moment there are not enough companies buying it so it is still not a commodity but an expensive buy. In addition whilst the policy triggers vary between the alternative offerings, most have significant retentions both monetary and time deductibles (as much as 7–20 days) which make the offering very unattractive,” he continued.

But if you gather the right information and present it properly it can work

“Our industry aggregations will never go away so we are where we are. That being said we secured more capacity than ever at last renewal based on a lot of hard work generating specific underwriting information on our suppliers which has taken time and patience to organise and many site visits to negotiate through our supply base people,” he explained.

Supply chain is a matter of risk management and business continuity first

“I think some companies became complacent and used to very lean, efficient supply chains. But Japan brought back into focus the risks inherent within just in time (JIT) techniques with a vengeance. At Morgan Crucible we have focused on improving our supply chain through focus on key suppliers and critical stocks. This impacts working capital of course. In some cases it is well worth investing in your business continuity management rather than trying to save up front costs. There is inevitably a cost involved in such investments but if you have two suppliers instead of one you have more leverage to negotiate.”

Reputation is not a risk but a consequence

“For me reputation risk is not a risk. It is a consequence of a number of risks produced by the business. Toyota’s recent recall problems were a consequence of production risk not reputation risk. The impact on the reputation of the company was a consequence not a risk in itself.”

Not sure the market has worked out cyber yet

“Cyber is such a big issue crossing many different aspects of any business. I am not sure many companies have really got their arms around it, and certainly the insurance solutions are not 100%. For us our bigger risks are generally not insurable—fraud, culture and behaviour, money laundering, data protection—although some of these things have the potential to translate into certain insurance matters such as professional liability.”

Cyber is no standard product

“It’s not an off-the-shelf purchase, so don’t approach it that way. Assess the risk, gap analyse what cover you already have and assess what might be available to insure residual risk. One of the biggest issues is educating the board in what these risks mean so that they can take informed decisions.”
Based on this year’s Risk Frontiers survey there is clearly no reason to panic about the availability of capacity for large corporate or industrial risks.

The customers are fully aware of the financial pressure that their insurers are under because of persistently low interest rates and poor returns on assets.

They are also aware that the reserves pot is inevitably starting to run dry and there is a chance that reserve additions may raise their ugly head in future, particularly for longer tail liability lines.

And, of course, Solvency II does not come cheap. Europe’s coming capital adequacy regime will inevitably add costs, may force some consolidation in the market and persuade some insurers to commit less capacity to more capital-intensive high risk lines.

But the longevity of the soft market and resilience of general capacity for industrial insurance buyers coupled with seemingly abundant reinsurance capacity, means that there is no panic building about an imminent hardening in terms and conditions based on this year’s survey findings.

This is presumably one of the reasons why corporate insurance managers seem to be so preoccupied currently with the apparent inability of the big industrial insurers to deliver more innovative covers.

If the insurers still have so much capacity to spare to compete for the standard risks why not risk a little on more adventurous coverages?

It should come as no surprise to anyone that the core debate in the industrial insurance risk transfer market in recent times has been so much more focused upon service rather than price.

The core findings of the question on the state of the insurance market in this year’s survey can be summarised as the following:

1. Demand flat, capacity high, so market still soft
   One suggestion from participants for such a stubbornly flat market in non-catastrophe lines is that demand is actually not that high currently.
   The ongoing financial crisis may be forcing the insurers to seek new premium volumes in new markets to compensate for poor investment income. But it is also perhaps forcing the customers to be more cautious in their buying habits.
   Lower demand and higher supply does not often lead to higher prices.
   Rufino Ribeiro, Risk Manager at Galpenergia, the Portuguese oil and gas company, said that, despite the financial pressures faced by all insurers, he has not seen major changes to the risk scenario or the state of the insurance market in Portugal.
   One thing that does worry Mr Ribeiro, however, is a perceived tendency among companies to cut their insurance budgets to try and save costs. “Some companies believe they can live with a little more risk and therefore one of the first areas to suffer cuts is insurance,” he explained.
   Marta Segura, Corporate Insurance Director at Prosegur in Spain, confirmed this tendency. “What I have seen is that capacity is being used in a more efficient way [by buyers]. In the past companies would buy more capacity than they needed because it was not so expensive. But now you have to show that you really need the capacity you are purchasing. On the other hand, insurance companies for some years have been more worried about their profits than their revenues. This is something that could trigger a hardening of the market in the future,” she said.

2. Quality of coverage more important than price
   Despite the noted tendency towards lower demand for
cover, a remarkably high number of this year’s survey participants said that the breadth, depth and reliability of the coverage is more important than the price.

While companies all over Europe are desperate to cut costs to maintain margins they are also equally desperate not to present shareholders and analysts with nasty surprises. Lack of coverage or coverage that does not work as expected when an event hits can provide such nasty surprises.

Creighton Twiggs, Group Risk Manager of Clariant International, in Switzerland said that in this tough operating environment risk managers need to focus on the basics and that means decent cover not necessarily the lowest price.

“Board members will ask about price of course but coverage is more important than price. Insurance is a put option with a right price, right covers and risk premium income for the insurer. If premiums double it is a distraction, at all times it is the insurance cover that matters. The premium will be irrelevant if cover is denied. Therefore insurance managers need to buy the right cover for the right price. It’s as simple as that,” he said.

One wonders, however, if the same group of risk and insurance managers would take the same position if the market were to suddenly harden.

3. No problem with terms and conditions, outlook fair

Risk and insurance managers who took part in this year’s survey may have asked some serious and searching questions about the ability and willingness of their insurers to engage in true innovation.

But at the same time the group seemed remarkably content with the terms and conditions currently on offer for their more standard coverage, no doubt a reflection of the prolonged high level of capacity and competition in the market as noted above.

There is increased talk among reinsurers and insurers of tightening conditions, higher limits and possibly exclusions in trickier areas as part of a creeping hardening.

But the big European insurance buyers who took part in this survey do not seem to be unduly concerned about the coming renewals. Most expect flat or slightly hardening general rates but some even still expect reductions and there was no notable talk of higher limits and tighter conditions.

Ivan Delgado de Robles, Risk Manager at construction firm ACS in Spain, gave a typical response when the Madrid roundtable was asked whether they were happy with terms and conditions in the aftermath of last year’s catastrophes.

“So far I have not seen changes to rates and conditions because of the catastrophic losses. It has become more difficult to find good coverage, rates and limits for earthquake risk in countries that have suffered quakes, but this is not something exceptional,” he said.

The French risk managers discussed the state of the insurance market in some depth. They recognise that pressure is building on the insurers but they do not fear a dramatic backlash by any means.

Gilbert Canameras, President of AMRAE, Director of Corporate Finance and Insurance at mining group Eramet, agreed with his Spanish peers that any pressure on prices and conditions is more likely to come, if at all, in natural catastrophe lines.

“In general terms, I do not think there will be problems of capacity in the insurance market,” Mr Canameras said.

“I believe the market is going to harden because of the natural catastrophes of last year and also because the occurrence of similar events in the future has not been discarded. Other natural catastrophes are going to take place, causing ever more losses, and insurers will try to limit guarantees. Not because of a lack of capacity, but because they will want to rebuild their reserves, either by increasing excesses or by reducing limits,” he pointed out.

Yvon Colleu, AMRAE treasurer and Risk and Insurance Director at industrial group Bouygues, noted that insurers have reduced the limits for some types of coverage after the recent series of natural catastrophes. “But it was probably not in a worrying proportion, and it depends on the regions where the company operates,” he said.

“In some products like the 10-year construction guarantee that is specific to France, the market is possibly reaching its limits. But we have not seen a hardening of the insurance market in general,” continued Mr Colleu.

The AMRAE treasurer is not concerned about capacity constraints in the market either, and also said that if any hardening comes about, it will mostly come because of the performance of insurance companies, which is currently not too much a reason for concern.

“The results of insurance companies have been mostly good in the first [and second] quarter, and we generally see a hardening of the market only after a run of very poor or even catastrophic results.”

But François Malan, Director of Risk Management at property group Nexity, said he believes insurers have become more selective about the risks they take on. “I am confident in the capacity of big insurers, but there is going to be a difference between a good and a bad risk,” he said.

“If a company is based in an area exposed to quakes, like Japan, it will have to pay higher premiums for its coverage, and the risk manager will understand that, because it is normal.”

But no general capacity issues should arise in the near future, he said. “I do not fear that major insurers will face a lack of capacity, and I believe they are ready to comply with Solvency II,” he said.

“For the last two or three years insurers and brokers have been warning about the arrival of a hard market, but it has not been the case. In any case, if there are pressures for a hard market, it will be because of insurers’ technical results,” added Mr Malan.
4. Security not a worry but keep an eye on it

The European and international insurance and reinsurance industry has coped remarkably well with the financial crisis and more recently the run of big natural catastrophes. Claims have been paid and the financial health of the sector has been fine.

The credit rating agencies have recently taken a much closer look at European insurers with exposures to those European states with fiscal problems such as Greece, Italy, Spain and Portugal. But the big industrial insurers de-risked their portfolios rapidly and there does not seem to be a big financial threat to the sector from this source, for now at least.

This would explain why security was not a big topic of discussion during this year’s survey, despite the fact that choosing a solid and reliable insurance partner remains one of the most important, if not the most important, roles of the risk and insurance manager.

The Austrians engaged in a robust discussion about the current state of the market that revealed the tricky position the insurers find themselves in as they attempt to boost revenues in a still highly competitive marketplace.

Klaus Grothe, Risk Manager with Andritz, the plant engineering group headquartered in Graz, pointed out that the financial instability generally has pushed capital towards more traditional and reliable markets such as insurance which is good news for insurance buyers.

“With the unpredictability of the euro I can’t imagine that capital would walk away. It seems that investors would prefer smaller but more consistent returns with insurers rather than banks because they don’t want to accept the risks,” he commented.

Michael Kleiter-Bingel of XL Group reminded the risk managers, however, that the industry has reached the ‘bottom’ of the cycle and results indicate that current pricing is not adequate. “After almost a decade of price reductions a correction is prudent. If clients choose to buy additional coverage, it should be appropriately priced and not just for free. That is the purchasing mentality that must change. The insurance industry is only able to deliver value when combined ratios are below 100%,” he said.

Mr Grothe pointed out, however, that the core job of an insurer is not to pick the rotten apples and thereby not punish the majority of those risk managers who do a good job by forcing them to effectively pay for the failings of the few. “You should be aware of the good clients, not picking those making the losses,” he said.

Mr Kleiter-Bingel replied, however, that even good clients face intensified risks and so insurers need to understand both good performers and those in need of improvement. “We must also distinguish between poor risks and heavy risks. We are not talking about changing policy and kicking out our best clients!” he said.

Mr Grothe, however, was typically blunt in his response as he said: “No. I do not want to support idiotic insurance buyers with no risk management!”

Mr Kleiter-Bingel said that Mr Grothe was of course correct, adding that well risk-managed clients are ‘appreciated’ regardless of their exposure profile. But, he added that the current high level of competition does not help. “The problem today is that another insurer comes along with an offer that is 10% cheaper and buyers jump on it for short-term gain, not considering the loss of quality services and partnership,” he added.

The insurer added: “We are talking about large complex risks here and so it should not be a question of lowest price only. You have to balance price against the right solution in combination with the right partner.”

Mr Grothe persisted, however, by stating that it is also about the opportunity cost for the insurance buyer. “If you are looking at service but the price elsewhere is cheaper it is difficult to tell the board no. If you are insured with a naive insurer and they go bust then all the better for you, as long as you don’t have a claim outstanding!” he said.

Mr Kleiter-Bingel concluded the debate by stating: “If I were a risk manager who had made that decision I would not sleep well at night.”

Mr Malan at Nexity in France was less relaxed about security than his Austrian peer. He warned fellow risk managers to keep a close eye on insurer results, as they are unlikely to be let off the hook if their bosses are surprised by the insolvency of one of their insurers.

“Risk managers have an important role to play in making sure that their insurers are in a healthy financial position,” he said. “AIG was an alert for us, and so were the recent problems of Groupama. We will be more protected with Solvency II, but we need to conduct financial surveillance of our main insurance partners,” he said.

Mr Malan added: “I think risk managers will be in trouble in the case of the bankruptcy of insurance firms that work with their companies, and they will need to explain to their boards what they have done to manage this risk.”

It is essential that a risk manager keeps a watchful eye on security. But the simple fact remains that, with capacity levels so high currently and the financial results of the insurers still healthy despite the poor investment returns, the soft, or at worst flat, market is confidently expected to continue for some time yet and will ensure that security is not a major concern, according to this year’s Risk Frontiers participants.

5. Solvency II: No dramatic change expected in industrial insurance market

The European insurance industry has expended a lot of effort in recent times trying to convince the market as a whole that the costs imposed by Solvency II, Europe’s planned new capital adequacy regime, will raise their cost of capital and inevitably mean that price increases are needed.
Most risk and insurance managers who took part in this year’s survey understand the logic behind the insurers’ arguments. But they do not really expect it to have a dramatic impact in reality over the short or long term. They believe that the costs should simply be swallowed by the insurers as a simple cost of business that should not be passed onto customers.

One Belgian risk manager said that he wished that the insurers would stop ‘bleating’ about Solvency II and just get on with the job of delivering adequate capacity to cover customer risks.

Daniel San Millán, Risk Manager at construction and concessions group Ferrovial and President of Igsa, summed up the overall feeling on Solvency II when he said: “In theory at least Solvency II should cause a hardening of the market. But we will see what will happen. Maybe the new rules will help some insurers to better manage their risks and as a result they will have lower capital costs.”

The discussion about insurance and the potential impact of Solvency II on the industrial insurance market during the Swiss roundtable in Zurich was representative of the general consensus among this year’s participants.

David Howells, Director Group Risk Management & Insurance at food processing and packaging firm Tetra Laval, asked XL Group’s Bruno Laenzlinger what he thinks will be the impact of Solvency II on insurers and the price of cover.

“I would assume Solvency II has its impact because it is a costly exercise to have to cope with the SST [Swiss Solvency Test] requirements and procedures. Without a strong financial basis an insurer is obliged to raise capital which can be a hefty burden today. These effects might bring up prices over time. I am not aware of any companies that have struggled to meet Finma’s requirements [the Swiss regulator] here in Switzerland. Generally speaking, it will change to a certain extent the insurance environment but probably not so much here in Switzerland,” he said.

Mr Twiggs of Clariant said that he cannot imagine that the costs will be that different and surely not big enough to affect the cost of capital. He was also quite positive about the overall effect of the rules.

“If you have a unified standard across the industry that has to comply with it and, if Solvency II is providing a level playing field beyond which insurers can adopt different models, then it has to be a good thing,” he said.

Sabrina Hartusch, Global Head of Insurance at Triumph International, the global lingerie company, pointed out that the impact ‘has to level out’. As a result risk managers may see a short-term price increase but not over the longer term because they are chiefly ‘up front’ costs.

Mr Laenzlinger pointed out that the SST has had an impact on how insurers structure their investment portfolios and Solvency II may have the same effect. “That may have an effect on returns,” he said.

Mr Howells rejoined on behalf of the buyers, however, as he said: “I don’t see the banks putting up interest rates because of Basel III. That is a cost for them but it should not affect their pricing. We, the customers, do not put up our prices because of regulation, it is just a cost of doing business that you have to manage and you have to find savings elsewhere.”

Mr Laenzlinger added that he believes the new capital adequacy rules will lead to less so-called naïve capacity in this market over time.

This is a logical assumption because such following capacity is often provided by smaller and less diversified players, which will presumably find life more difficult under the new solvency regime.

Philippe Guerry, Directeur MF Risk Services, the risk arm of Group Maus Freres, the privately held retail group, agreed that Solvency II is likely to sharpen the focus of insurers upon costs generally.

But, given the highly competitive nature of the market, he, along with many others, does not think that this will necessarily affect prices.

The bottom line is that the participants in this year’s Risk Frontiers survey do not believe that Solvency II will have a dramatic impact upon the provision of industrial insurance capacity.

The added costs and higher capital charges for higher risk lines will sharpen minds and could lead to the loss of some supporting capacity. But this really should not significantly affect the market for larger corporate insurance buyers, particularly those with decent loss records and well risk-managed risks, argue the buyers.

6. No radical change in captive strategy planned
Solvency II treats captive insurance companies in the same way as any standard commercial insurance concern, even if they only underwrite parent company risks.

The Commission does accept, however, that captives are different. Because they generally pose less of a systemic risk than commercial insurers that write large volumes of third party risks they will theoretically be granted proportional (lighter) treatment in terms of both capital and reporting requirements.

Risk management representative bodies such as the European Captive Insurance and Reinsurance Owners’ Association (ECIROA) and Ferma have campaigned hard for clarification of how these rules will be applied.

There is a fear that, because the Commission and the pan-European regulatory body—European Insurance and Occupational Pensions Authority (EIOPA)—refuses to give detailed guidance about how proportionality will be applied in practice, it may not happen, at least how originally envisaged.

The worry is that if the application of the principle is left up to national regulators then they will naturally err on the side of caution and make life as difficult as possible for captives, particularly on the reporting side.
The risk and insurance managers who took part in this year’s survey are, however, not in a state of panic about the impact of Solvency II on their captives.

Yes they would like greater clarity about how the rules will be implemented and how the proportionality principle should be applied. And some believe that there may be a migration of captives away from EU domiciles to those outside of the EU such as Guernsey which will not have to apply the new rules.

But the feedback from this group of leading European captive owners certainly did not suggest that there will be a Europe-wide cull of captives as a direct result of Solvency II.

Rufino Ribeiro, Risk Manager at Galpenergia, the Portuguese oil and gas company, said: “We had an initial shock, but after we all took the QIS5 tests, we saw that our captives were not too far away from forthcoming capital requirements. But Solvency II will evidently cause some problems. Once again, it is a very heavy European legislation that hit European companies. It may force some companies, especially large groups which have captives in Europe, to take them elsewhere.”

José Luis Amorim, Risk Manager at Sonae Group, the retail and telecommunications group, said location is the key point for him. “The problem will be where to. In the United States they are already studying adaptation to Solvency II requirements, Bermuda too. And some of the remaining jurisdictions are not for the faint-hearted. But the general conclusion seems to be that Solvency II will not change the relationship of costs and benefits, even though costs are likely to go up for captives,” continued Mr Amorim.

Creighton Twiggs of Clariant in Switzerland said that for his group’s captives he uses QIS5 to judge business strength and sees no reason for panic.

“I think we are seeing an awful lot of hot air from the pressure groups. We are considering captive relocation and the highest level from a regulatory perspective is a key factor. Why are we doing this? Perception. There is still an idea that captives are set up in offshore domiciles to avoid tax. I am ready for the serious discussion with fronting companies that adopt their own solvency test,” he said.

Leading French risk managers interviewed for this year’s French leg of the Risk Frontiers survey have become increasingly confident that the monster is unlikely to be as ugly as initially feared.

The directive could even create opportunities for firms that are prepared to fully understand the rules, they said. “Solvency II could generate good opportunities to buy an existing captive, one that is already mature,” said François Malan, Risk Manager with property group Nexity.

“Some companies are selling their captives to bring money back to France, so buying one could prove to be a better deal than setting up a new one from scratch,” he said.

That is one of the options being weighed by Mr Malan’s company, which does not own a captive yet. With the situation still evolving, he is studying the subject closely to identify the best alternatives.

“Some companies are looking at options to have a captive in Luxembourg, which looks for me the best jurisdiction today,” he said. “But this is something that can change. Maybe one year from now the best jurisdiction will be Dublin or somewhere else. When you study the subject, the impact to Solvency II on the captive strategy emerges as a major point. And the answer is that it may be necessary to put more money in the captive than was the case previously.”

Mr Colleu said, however, that in his view there is still plenty of uncertainty about the future of captives. He agreed with most, however, that Solvency II is not likely to completely blow up the strategies for now at least. “Solvency II will mostly impact the cost structure of captives, as they have to formalise its risk management procedures. But as a principle this is a good idea,” he said.

“The then there is the principle of proportionality that the directive proposes, and as of today we do not have all the elements to evaluate which will be the level of exigence [an imperfection marked by urgency] from the regulators. We have to wait to be sure about the extra management costs for captives, but it is likely that small captives will be more affected than the large ones,” Mr Colleu added.

AMRAE president Gilbert Canameras summarised the general feeling of comfort about Solvency II’s potential impact on captives as he said: “Solvency II is not going to change our captive strategy. As far as I can see, reinsurance captives kept by industrial groups are not going to be affected. Perhaps there will be restrictions to what we call provisions for the fluctuation of loss ratios, but in our particular case I do not believe this will be a problem,” he said.
During his headline speech at the DVS annual Symposium in Munich at the start of September, Mike McGavick, CEO of XL Group, told German risk managers that we are amidst an ‘exciting time’ in the history of the industry. But he warned that the entire market needs to wake up to the threats posed by rapid economic change.

“My purpose here is simple. To make sure we all understand the gravity of the situation today and reconstruct ourselves to increasing the relevance of the industry to our clients,” Mr McGavick explained to the massed ranks of German risk managers and insurance market professionals.

Mr McGavick's comments at the DVS and during an interview the following week at the Monte Carlo reinsurance market Rendez-Vous rung very clear with the overall impressions gleaned from this year’s Risk Frontiers survey.

Europe's risk and insurance managers find themselves currently amidst a scary and exciting period of corporate, economic, political and financial change that shows no sign of letting up.

Risk management has never enjoyed a higher profile and, with the support of the insurance industry, today's corporate risk and insurance managers have the opportunity to elevate the profession onto a higher plane.

The big question thrown up by this year's survey is really whether the European risk and insurance management profession is willing and able to grasp the opportunity and whether the insurance market is willing and able to take the plunge too.

Mr McGavick is clearly keenly aware of the fact that the market finds itself at a significant inflection point. During his speech in Munich he pointed out that the world is changing very fast currently and yet, based on the existing numbers, the relevance of insurance is in decline.

“You know this for certain and this is the frustration you experience when you try to find relevant products. We need to rediscover our relevance and make sure we make the difference we are intended to make because when insurance works right the world moves faster, if not it moves slower,” he said.

To emphasise his point Mr McGavick said that between 2002 and 2011 the real gross domestic product (GDP) of the world increased by an average of 3.8% a year. Over this period insurance premiums also grew from $1tn to $2tn, a growth rate of 2.5% a year. But during the same period, the industry's contribution to global GDP dropped from 3.4% of the economy in 2002 to 2.8% in 2011. “Our share of economic activity therefore declined. We are literally becoming less relevant,” said Mr McGavick.

Two important sectors
The insurer said that the cause of this problem is easy to illustrate by looking at two important sectors; technology and energy.

He pointed out that of the world's largest five companies by market capitalisation, all are now from either the energy or technology sectors. They are Apple, Exxon Mobile, Microsoft, China Petrol and IBM. “This is absolutely incredible,” said Mr McGavick.

He said that in technology the changes happen ‘ever more quickly’. For example, in 2010 there were 1.15 billion smart phones in use. By 2020 there is predicted to be 4.3 billion. The percentage of phones used as smart phones versus regular phones is 27% today. By 2020 it will be 80%.

“Why is this so important?” he asked.
Mr McGavick said that Mannie Reesenkamp, the so-called Warren Buffet of the IT investment world, has been quoted as stating that he invests in companies and ideas that use mobiles to ‘destroy’ industries such as watches, cameras, video cameras, newspapers and books.

“We used to insure these industries and these products and they have gone and been folded into this thing (the smart phone) which, outside some warranty products, we hardly insure,” explained Mr McGavick.

“This is why GDP has grown by 3.8% and the insurance market by 2.5% because when atoms are blown to bits we are not very good at it. We are used to insuring good physical things, with ideas we are not so good,” he added.

Mr McGavick said it would, however, be unfair to suggest that the insurance market is not trying. For example, the first cyber risk insurance product was launched in 1998 and today, he calculates, this is a $1bn market with about 30 insurance companies providing the cover. “The most exciting thing of all is that most companies don’t buy it and they need it,” he said.

But, Mr McGavick said that the problem remains. The balance sheet of the US P&C industry is estimated to be about $176bn in gross written premiums which is about 25% of Apple’s market capitalisation.

Mr McGavick said that the energy market also presents a challenge, albeit a somewhat different challenge to that presented by the technology sector. He said that the Gulf of Mexico (Deepwater Horizon) disaster was a good example of the challenge faced by insurers.

“The overwhelming majority of the loss was borne by the balance sheet of BP, by choice. We were deemed not big enough to be relevant. But this was not a balance sheet problem, this was an idea problem,” he said.

‘Great pause’

“I think if BP had been insured its position would have been better. We have insight to offer that is not made available enough to companies like BP that choose to go it alone… and this should give us great pause for thought,” continued the insurer.

Mr McGavick also said that global supply chains have radically changed the way business has operated in recent times and that recent experience has shown that the industry is not doing its job properly.

“Shame on us. How long have we been talking about just in time production? Two decades. This has been known by us for a long time and yet industry has done nothing to manage the risks. We have missed things and the cost has been tremendous,” he said.

Mr McGavick said that the insurance industry has a lot to learn to solve this problem and its response so far has not been great. Fear of the apparently unknown has driven exclusions and limits. “This is unacceptable and if it is not sorted out with clients our percentage of GDP will continue to decline,” he said.

So what is the solution?

According to Mr McGavick insurers simply have to get closer to their clients and work harder to understand their problems. XL Group is, for example, running innovation councils and so is investing in this ‘today for tomorrow’, he said.

But the key challenge for most insurers is to deploy the best talent to this critical area, according to Mr McGavick.

“In most companies where you make the most money the best talent lies. This is a mistake. Once you have figured this out you don’t use the best talent to keep the business ticking over, the best talent should be on innovation,” he said.

“I am not pessimistic but we have to tackle the talent challenge. The best talent has to be applied to the challenges. It is not about what you are already good at but what you need to be good at,” continued Mr McGavick.

He also said that the days of long delays are gone. “It needs to be today’s data that is used. Think about it for a year and then you are limited…in that time an entire industry comes and goes. That manual won’t work any longer,” said Mr McGavick.

‘Invest in analysis’

The next key focus has to be on data and its intelligent use, said the XL Group CEO. He said that there is a vast pool of information available that could help create new products to solve client needs. “You need to invest in analytical tools and people and use them because the answer to the problem is these data pools if you don’t want the industry to be gone,” he said. Another challenge is capital formation, said Mr McGavick. He pointed out that the sector trades below book value and that this is basically a bet that it will be less relevant over time.

One reason for this regulatory uncertainty is increased capital regulation and this will inevitably lead to more M&A activity to rationalise the capital base, said Mr McGavick. This is not necessarily good news for those insurance managers in search of innovation.

“If Solvency II does not become more clever the industry will start to look like the utility industry. There is no greater threat to the customers of insurance than an industry composed of fewer players with less need to listen,” he said.

But history does prove that the insurance industry is capable of responding to such crisis points, said Mr McGavick. XL Group itself, along with ACE, was founded in a similarly dark time when the US liability crisis of the mid-1980s threatened to shut down US industry.

Mr McGavick recalled a Time magazine headline: ‘America: Your insurance is cancelled’. “But the response was innovation. A couple of companies [XL Group and ACE] were formed and we managed to innovate our way out of it. It is in our DNA and this is encouraging for us and the sector as a whole,” said Mr McGavick.

“We are in difficult times but we don’t get to do this kind of thing without hard work. We can reclaim our place,” he concluded.
ADRIAN LADBURY (AL): What risks keep you awake at night? What is the role of the broker when dealing with emerging risks? Are you doing enough to tackle emerging risks and what more needs to be done to meet customer needs?

ADAM GARRARD (AG): When it comes to developing solutions to emerging risks, the insurance industry has to give itself some credit. Clients and indeed society as a whole are continually looking for solutions to emerging risks and the market has responded. Business interruption, directors’ and officers’ and cyber are all significant solutions that were once emerging risks. This identification and innovation continues today. Perhaps the pace of development is not what it could be but we are usually dealing with complex issues where society and the law have not yet a full understanding of the risks and implications and as such the insurance industry needs to make sure that it takes its time and gets it right the first time.

What is keeping us awake (and indeed alert) are the risks for which we haven’t yet created solutions. There are risks for which there is not yet a transfer or even a control solution. That is both worrying and exciting.

I think there is probably one risk above all that is discussed at length in boardrooms across the world and for which there is not really a solution although work is going on to find a solution. That risk is reputational risk in all its forms. It has the ability to be truly catastrophic especially in this age of multimedia. Nothing is a secret for long anymore and when it is out there it is out there everywhere.

A number of banks are currently experiencing reputational problems because of the Libor scandal, that is a fact. But what is the effect of that reputational problem? The biggest single issue for any company caught up in a ‘scandal’ is loss of value. Just when they need funds the most to mitigate the effect of the scandal it is likely that, because of their loss of value, they are going to find those funds harder to obtain.

If a major event occurs, the core value of the company tends to fall immediately and that is when a company needs cash to protect its balance sheet or to expend on advertising and PR activity. Also, investor confidence, liquidity and customer loyalty often evaporate. In addition, management is often under close scrutiny during these events.

When thinking about a potential solution, you essentially need to develop a mechanism for the efficient transfer of brand and reputation risk as part of an overall plan for resilience during a corporate crisis, so that when the next corporate crisis occurs, recovery is quick.

AL: One of the big problems raised by risk managers in this year’s survey about emerging risks is the time that is taken to develop new solutions—it is simply too long and cumbersome, they say. Do you think this is fair and how can expectations be managed?
**AG:** I don’t think the insurance industry has sold itself too well in this respect because there are risk managers out there who think that we in insurance simply make excuses. But we are trying not to do that. Our job, particularly as brokers, is to help the client identify risks and only then can we help them decide what to do with it, which may be to partly or wholly transfer the risk to the insurance market. For example clients can buy cyber coverage but the details of their own IT security are often so secure they can’t offer the right information for insurers to assess the risk. Therefore as brokers we have to step in to help the clients with their risk management.

The transfer of risk is the output of all the identification and analysis of risk that takes place before it. Transfer is only part of the solution that the client needs. Sometimes the insurance transaction works but a good broker will also help find other solutions. A transaction will take place if the market can offer a solution that is priced better than the cost of mitigating or of completely avoiding the risk in the first place. So we are working on risk mitigation and control as much as transactions.

In this sense, insurers are competing with mitigation and control of risk and not just against each other. It is, in my view, the insurance broker that makes sure the insurer is competing against mitigation and control. We employ hundreds of risk engineers who are not transfer specialists but advise clients on what to do to mitigate risk. We have a team of analysts who do not focus on creating price competition between insurers but who analyse the risk environment that the clients operate in and help them assess at what price it is better to transfer than to retain.

You see innovation and solutions come in many forms and not just the ‘traditional’ insurance transfer product. Insurance brokers are at the forefront of that innovation and if transfer is the best mechanism then it is my experience that our insurer partners are receptive and innovative.

**AL:** Do you therefore in some respects compete with the insurers in areas like risk engineering, which the industrial insurers are really pushing currently?

**AG:** I don’t think we are competing because we have a different role and agenda. If you are a risk engineer working for an insurance company then your job is to protect the underwriter, this is your primary responsibility. There is nothing wrong in that. It is the agenda of the insurance company and why wouldn’t it be. Our engineers’ role is very different. We are not there to promote the best outcome for the insurer, we are there to promote the best outcome for the client. Our advice will be what represents the most cost effective solution for the client, be that avoid, mitigate or transfer. An insurer’s engineer will look to provide the most cost effective solution for the underwriter. There is no conflict here, it is purely a fact that the two engineers are working for different masters and as such have different priorities.

**AL:** But how can this be the case when brokers are paid fees and commissions by customers to place coverage with the insurers and also by the insurers for services carried out for them?

**AG:** We are independent of the insurance company. Our number one task is to reduce the total cost of risk for the client and the way we do that is to reduce the cost of insurance, reduce the under-deductible losses and reduce the cost of administration. We do this through the identification and analysis of client risk. We then propose the optimum solution, which will be a blend of avoid, mitigate and transfer. That is what a good broker does and that is what the client pays for. How the client pays for that, be it via a fee or as a commission on the insurance premium, is up to him or her. At Willis this is a moot point because, unlike some insurance brokers, we are transparent about what we earn regardless of the form it takes.

In addition it may be that we undertake work on behalf of the insurer. We may administer a facility for them whereby we draft and issue the policy. We may provide insurers with research, benchmarking and insurance holistic pricing information. Insurers pay us for that work.

What I think that your question is referencing is the payment of contingent commissions. Payments made purely on the basis of the volume of business a broker places with an insurer or the profitability of the business the broker places with an insurer. Willis’ position on this issue is clear and unambiguous. We do not like them, and we do not take them except in one area, US EB [employee benefits], where we are forced to. We wish the industry would follow suit but it has chosen not to so we sit alone. But we have a loud voice and we have tried to get our industry colleagues to follow our lead. The most powerful voice of course is that of the client and we ask them to join us on this crusade.

**AL:** One comment made by many risk managers, particularly those working with large companies that have big risk management departments and perhaps in-house brokers, in this year’s survey and last year was that neither the brokers or insurers have the right kind of people to really tackle the complex and fast-changing risk environment. Is this fair?

**AG:** We cannot do this job without the right people and whether brokers have the right people or not is something you could argue forever. What I can say is that our retention rate of clients as a group is 92% and for Europe is more like 95%. I hope this is because we are doing a good job and not because others are simply worse than us! We have invested and continue to invest significantly in building the right teams with the right skill sets. The world is ever changing and our proposition needs and I believe does change with it. I guess the proof will be in the results. Brokers will continue to flourish if they continue to add value; they will die if they do not.
The Participants

This year’s Risk Frontiers survey was the biggest yet with a total of 75 participants who took part in national roundtable discussions and individual interviews in 11 different European countries between March and July. Russia was the latest welcome addition to the fold and we look forward to working closer with RusRisk over the next 12 months. Of the 75 participants 60 were corporate risk and insurance managers with leading European corporations and the balance were representatives of the project sponsors XL Group and Willis. CRE extends a huge thank you to all those individuals who took part in this year’s survey and the support of the national risk management associations with which we worked to make the roundtables happen. Thanks to all.

Austria

- **Martina Heiss**, Manager within the Accounting, Taxes & ICS Group at telecommunications firm A1 Telekom Austria
- **Martin Cerny**, Facility & Resource Management Insurance at A1 Telekom Austria
- **Olaf Köhler**, Risk and Insurance Management at OBB, the Austrian railway network
- **Klaus Grothe**, Risk Manager with Andritz, the plant engineering group
- **Michael Kleiter-Bingel**, Regional Manager Austria & CEE at XL Group

Belgium

- **Gaëtan Lefèvre**, President of Beltrim and Group Risk and Insurance Manager at engineering group CMI
- **Olivier Mounal**, Vice President Risk Management at telecommunications firm Belgacom Group International Services
- **Sonia Cambier**, Risk Manager with Solvay, the international chemicals and plastics group
- **Catherine Van Cauwelaert**, Director—Head of group insurance management at Euroclear, the financial settlement group
- **Sabine Desantoine**, Insurable Risk Manager at financial services group ING
- **Malou Gossez**, Risk Manager at glass manufacturer AGC Glass Europe
- **Rudi Casteels**, Client & Distribution Leader Benelux Region for XL Group

France

- **Gilbert Canameras**, President of AMRAE, Director of Corporate Financing and Insurance at mining group Eramet
- **Yvon Colleu**, AMRAE treasurer and Risk and Insurance Director at industrial group Bouygues
- **François Malan**, Director of Risk Management at property group Nexity
- **Bruno Dunoyer de Ségonzac**, Head of Risk Management and Audit at Bouygues Télécom

Germany

- **Klaus Greiemel**, Managing Director, E.ON Risk Consulting, the energy group
- **Jurand Honisch**, Senior Vice President, Corporate Risk Management & Insurance Corporate Treasury and Finance at publishing company Bertelsmann
- **Klaus Braukmann**, Managing Director, Conti Versicherungsdienst, the insurance arm of the automotive manufacturing company Continental
- **Edwin Meyer**, General Manager, Risk and Insurance at steel and mining company ArcelorMittal
- **Hans Martin Schindewolf**, Chairman, Daimler Insurance Services, the financial services arm of the automotive company
- **Gregor Kühler**, CEO and President of Pallas Versicherung, the insurance arm of pharmaceuticals and chemicals group Bayer
- **Alexander Mahnke**, CEO Business Unit Insurance at Siemens, the engineering and electrical company
- **Sabine Segor**, Head of Risk & Insurance Management at Hugo Boss, the fashion company
- **Hans-Jürgen Allerdissen**, Managing Director at Deutsche Verkehrs- Versicherungs- Vermittlungs, the insurance arm of Deutsche Bahn, the German railway operator
- **Mathias Pahl**, CEO of Willis Germany

Italy

- **Paolo Rubini**, Risk Manager, telecommunications group Telecom Italia and President of Anra
- **Jorge Luzzi**, Group Risk Management Director for Pirelli worldwide and President of Ferma
- **Alessandro De Felice**, Group Risk Manager, Finance, Administration, Control & IT at Prysmian Group, producer of high-technology cables and systems for the energy and telecommunications sectors
- **Marco Terzago**, Corporate Property Risk/Insurance Manager South Europe & Asia at meetings, lubricants and engineering group SKF Industrie

Netherlands

- **Hans Gorree**, Directeur Corporate Risk & Insurance at construction group VolkerWessels
- **Adri van der Waard**, Insurance Manager at ARCADIS
- **Tjerk van Dijk**, Director Insurance at aerospace group Stork/Fokker
- **Annemarie Schouw**, recently elected President of Natim and Risk & Insurance Manager, Tata Steel
- **Jacqueline Plessius**, Senior Insurance Manager Group Treasury & Insurance at logistics company TNT Express
- **Sandrine Hogenoorzen**, Client & Distribution Leader for Benelux, XL Group
- **Rob Wagenvaart**, Director Special Projects, Large Accounts at Willis

Portugal

- **Allen Lima**, CRO at EDP, the electricity provider
- **Rufino Ribeiro**, Risk Manager at Galpenergida, the oil and gas company
- **Mariana Lopes**, Head of Risk and Financial Management at brewery group Unicer
- **José Luis Amorim**, Risk Manager at Sonae Group, the retail group
- **Luís San Juan**, Client & Distribution Leader—Iberia and Latin America, XL Group
- **Crispin Stillwell**, New Business Director and member of the board of Willis Portugal

Spain

- **Daniel San Millán**, Risk Manager at construction and concessions group Ferrovial and President of Igiea
- **Marta Segura**, Corporate Insurance Director at Prosegur, global security company
- **Miguel Angel Zarandona**, Group Head of Risk and Insurance Management at retail group El Corte Inglés and Vice-President of Aegon
- **Mário Ramírez**, Head of Insurance and Risks at logistics group CLH
- **Ivan Delgado de Robles**, Risk Manager at construction firm ACS
- **Luís San Juan**, Client & Distribution Leader—Iberia and Latin America, XL Group
- **Iván Sainz de la Mora**, Deputy General Director, Willis Spain

Switzerland

- **Creighton Twiggs**, Group Risk Manager at chemicals group Clariant International
- **Sabrina Hartsch**, Global Head of Insurance at Triumph International, the global lingerie company
- **Philippe Guerry**, Directeur MF Risk Services, the risk arm of Group Maus Freres, the retail group
- **David Howells**, Director Group Risk Management & Insurance at food processing and packaging firm Tetra Laval
- **Maurizio Micale**, Director of Risk Management and Insurance of computer chip manufacturer STMicroelectronics
- **Bruno Laenzlinger**, Country Manager Switzerland at XL Group
- **Filipe Gomes**, Head Finex, Willis Switzerland

UK

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