

New game, new rules



The world is today a riskier place and businesses need to react quickly to unforeseen challenges. Risk managers from three very different organisations are confronting a hazardous array of risks. By Lee Coppack

Our current financial problems have created new risks and exacerbated existing ones with unprecedented speed and severity. The environment, including the insurance market, is unsettled, and the world seems to be, as the World Economic Forum's 2009 Global Risk Report concluded, a riskier place.

"Whatever industry you consider, it is always the same pattern," says Erwann Michel-Kerjan, Managing Director of the Risk Management and Decision Processes

Center at the Wharton School in Pennsylvania. "Things are getting faster, and therefore we have to make decisions faster, but based on information that we often don't have." He believes that companies can no longer look at the risks independently of each other, but they will need to understand the links and interdependencies.

Speed and scale of change

Julia Graham, Chief Risk Officer at international law firm DLA Piper and this year's Chairman of the UK risk management

association AIRMIC, shares Michel-Kerjan's views. "The speed of change is challenging conventional thinking," she says, comparing the current situation with her experience of 35 years in insurance and risk management. "These risk profiles have some common issues: we are living in a riskier world. More risks are increasing in profile, rather than diminishing."

Risk managers are concerned more than ever about the sustainability of supply chains and customer demand, related business interruption and reputation risks, fraud and other crime, and greater political instability. More regulation and legislation will affect everyone, especially financial services. Graham adds, "Of course, the most significant issue is the change in the financial context in which we all work."

globally, by about the same amount in each country, and almost simultaneously, with a sharp acceleration in early November 2008. "It was very quick," confirms Ian Beale, the company's Director of Audit and Risk.

"The recession has exacerbated certain risks," says Beale. "We responded swiftly with decisive action which we believe will enable us to deliver a solid performance during the downturn and prepare us to emerge stronger when the markets recover."

According to Beale, Inchcape is a very risk aware business thanks to its CEO, Andre Lacroix, who chairs the group's risk committee and is closely involved with risk management decisions. He led a process of measures to mitigate the impact of the downturn and reassure the market.

A different perspective comes from global

“Companies with a robust, enterprise-wide approach to risk, will be in a good position to manage the insurance cycle.”

The major challenges facing law firms, according to Graham, include the demands of an increasingly global client base and new regulators with potential administrative and financial burdens.

Financial risks, such as bankruptcy or consolidation among significant clients, are also concerns, although being full service in a large number of jurisdictions is a great risk mitigation factor. Further, firms that are global and local have a greater in-built financial resilience to the downturn, as do those that are nimble and agile in their management responses.

Graham also cites falling demand for external legal services, as well as more traditional aspects of the risk manager's portfolio: a catastrophe that disrupts the business, terrorism, information security and losses that could exceed insurance policy limits.

The effect of the downturn was felt rapidly at international car retailer and distributor Inchcape. Markets fell at around 20 per cent

engineering, consulting and construction company Black & Veatch (B&V). The long-established, employee-owned company, with headquarters in Kansas, has not suffered such an immediate impact. The effect of the recession so far has been to slow projects while promoters wait for approval for finance, according to Kirk Woodward, its Senior Vice President – Risk Management and Administrative Services.

"The projects haven't been cancelled," he explains, "but they have been delayed, until the clients know how the economy is going to turn out. For B&V, President Obama's stimulus package should bring opportunities in different ways at different levels."

Insurance counterparty risk

Having been a risk manager since 1986, Woodward remembers previous recessions, as well as the upheavals that followed the 11 September 2001 terrorist attacks. The current recession is different because it is more financially driven. "Insurance >>>

VIEWS FROM THE FRONT LINE



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“»»»» companies are financial institutions, so it is impacting them very hard. We do have fears about the financial stability of many carriers.”

The security of their insurance is a major preoccupation for many risk managers. Surveys of members of AIRMIC and of the European Federation of Risk Management Associations (FERMA) have indicated that insurer security has become an issue for finance directors which it has rarely been before. “It is now on the radar of senior management,” says Franck Baron, Vice President of FERMA. “Companies are looking very carefully at the counterparty risk they run with their insurers, which until a year ago was not perceived as critical.”

Graham is also concerned about “insurers (or brokers) not being there to respond when needed”. She says her firm has contingency plans in case insurers get into trouble and is spreading its business more widely. “Have a plan,” she says. “It’s too late to plan when things go wrong.”

Spreading major property programmes among insurers and carefully selecting underwriters for specific lines, especially long-tail liabilities, are the methods that commercial insurance buyers are generally adopting to

reduce their exposure to counterparty risk, according to Chris Tabbitt, Property-Casualty Team Leader of the Global Risk Solutions Division at Jardine Lloyd Thompson. “Clients are looking at their relationships with insurers,” he says. “They do not want too much counterparty risk with any one insurer, either on a single line or across the portfolio.”

Minimising costs

Corporate insurance buyers are also waiting uneasily to see if the insurance market will suddenly and sharply harden. Capital is in tight supply, investment income is falling and the cushion of reserve releases has gone, but prices have yet to move much, with the exception of a few unsurprising classes, the most conspicuous being US directors’ and officers’ liability and Gulf of Mexico windstorm.

“If you look at the market overall at the moment,” says Ron Hayes, Managing Director of Jardine Lloyd Thompson’s Global Risk Solutions Division, “this cycle is certainly quite different from any other I’ve experienced, and I’ve gone through four hard markets. It’s very segmented and has yet to find its level.” However, insurers are discriminating between clients with long-term

relationships and opportunistic buyers. “Long-term clients are definitely getting a better deal. Some underwriters are really making a distinction.”

All three businesses are committed to long-term relationships with their insurers. For example, Woodward says his insurers have been the company’s financial partners for many years, and B&V does not plan to switch. “They have been very loyal and they have been there for us in the long term. We plan on being there for them and remaining loyal. If they are having to struggle now, we believe they will emerge the stronger for it.”

Helping cash flow

These experienced risk managers understand thoroughly the dynamics of the insurance market, and must balance carefully their risk appetite, risk transfer and cash flow requirements. All three have captives, for example, and are considering the best ways to use them. Although this is a regular exercise, it will help them prepare for tougher insurance conditions if the market turns.

Inchcape has a three-year global programme, the third year of which will renew on 1 July. Beale has met all the group’s insurers, broker and captive manager. He expects to see the challenges from the industry downturn translated into an adjustment in the premiums.

He has also challenged them to rethink some fundamental issues, for instance: does Inchcape need the extent of cover it has now, what excess should the company carry and what role should the captive play?

Changes to the insurance programme large enough to save money would have other implications. “If there is a material cost saving, it is with the clear understanding there will be a change to the risk profile,” accepts Beale. “We want our broker and insurers to be a bit creative and see what we can save.”

The economic situation has forced risk and insurance managers to respond to a rapidly developing situation. Companies which have a robust, enterprise-wide approach to their risks will be in a good position to manage the insurance cycle and will be prepared to take advantage of commercial opportunities as markets emerge from recession. **RS**

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