

RISK PROFESSION

Conference 2009 highlights - issue 1

Top 10 risks exposed

A panel of experts at the RMIA conference had different perspectives on exactly what the top 10 risks are, but shared the view that enterprise risk management was needed to cope with a risk environment dramatically altered by the GFC.

In a survey compiled by Ernst & Young, 'the credit crunch' topped the list, followed by regulation and compliance. Craig Jackson, E&Y Oceania Risk Network leader, told the RMIA conference regulation risk was "a bullet performer", moving from 22nd place last year to 10th. He predicted the need for stakeholder confidence would see it escalate in importance. But he warned that reputation risk was a consequence of other things and it was more important for risk managers to ask what could damage their organisation's reputation.

Gary Lynch, global leader, supply chain and resiliency, with Marsh Risk Consulting, New York, said he had struggled to develop a 'top 10' because there were so many variables, like the industry and geography. Supply chain risk was "at the top of the list, but is the risk that's least understood". Other threats were pandemics, weather perils, particularly as businesses moved into more hazard-prone areas, IT and new technology, and new business partners.

In the supply chain, the inability to see beyond immediate links, interdependencies, which created knock-on effects, and aggregation were issues. Eg, 72% of the world's exports go through only six ports. In 2003, a major US retailer sourced only 6% of goods outside the USA; today 80% came from two Chinese provinces.

ANZIIF CEO Joan Fitzpatrick named restoring trust in businesses and attracting and motivating the best talent as two key risks. She called on senior executives and CEOs to set limits on their own remuneration rather than waiting to be "over-regulated or badly regulated". Boards had to replace cronyism with transparency and managers should

consider long-term sustainability, not just profits.

Employees wanted purpose in their jobs and employers needed to motivate them. "Gen Y and knowledge workers are not just money motivated, they want to ensure the long-term health of the company," she said.

Kai Dwyer, Zurich's head of global corporate, Australia, said the GFC had seen an overreliance on a playing field established by regulators. He urged businesses to not just follow the rules but embed an enterprise risk management (ERM) culture. "Every employee must be aware of the importance of good conduct and best practice."

RIMS USA president Joseph Restoule said proposals to mandate board risk committees were "a real opportunity" for the risk profession. Someone needed to educate boards on ERM, which was a role for RMIA, RIMS and equivalent bodies in other countries.

He said there was an over-reliance on models, but who was stress testing the models? "They are not failproof." Customer risk was an issue because customer goodwill was at an "all-time low". "Opportunistic lawyers are watching," he warned.

Cutting back on R&D was a risk, as was director and executive accountability. Court action on culpability for Hurricane Katrina showed operational risks could not be moved to the sideline. Failure to engage with new technology, like social media, was a potential mistake, Mr Restoule said.

Pure salesmen won't survive

Brokers who are no more than insurance salesmen will not survive, says NIBA CEO Noel Pettersen.

He told the RMIA conference people who were conscious of business security respected the need for professional advice and having "someone on their side". "They know the value a broker can bring."

Brokers had gone through compliance overload with the 2004 introduction of the *Financial Services Regulation Act*, but had at least managed to peg back on some of the over kill.

"Do consumer friendly laws really work," Mr Pettersen asked. "Nothing replaces common sense and a bit of knowledge."

The upsides of the *FSR Act* were measurable, industry-wide standards, higher levels of education and training, and defined competency pathways for brokers.

A broker survey found 71% rated the GFC as their toughest challenge in the past 12-18 months, but climate change, the ageing population, and the power shift to India and China were other challenges. While brokers had not suffered significant GFC-related costs, some clients had cut costs by increasing deductibles or cutting insurance levels, which impacted on premiums.

Mr Pettersen described the level of tax on insurance, particularly in country Victoria, as "farcical".

More than 30% of buildings damaged in the Victorian bushfires were underinsured. The fact that those without insurance received government assistance "sends the wrong message to the community" and to "prudent policyholders".

Life insurance levels were also low. Only 30 life claims had been filed, although there were 173 fatalities.

Mr Pettersen said NIBA would continue its fight against world-record taxes on insurance which were "a cash cow" in NSW and Victoria.

"The gloves are off and we're in there for the fight," he said.

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Brokers' market share was increasing and internet purchasing had had little impact, particularly in commercial lines. However, the aging population was an issue, with the average broker principal aged 56-57 years.

Mr Pettersen described cluster groups as "vital to the lifeblood of smaller brokers", giving them more leverage with insurers, marketing muscle and succession plans.

He didn't see their provision of training and other services to members as a threat to NIBA, saying the NIBA role was all embracing. It provided lobbying in the regulatory arena and back up education and training.

Professionalism was the lynchpin of broker resilience; brokers had to supply a high level of customer service.

"The insurance industry undersells itself; we must add value with more RM advice."

Prioritise supply chain risks

Globalisation has escalated the importance of supply chain RM, says Gary Lynch, US-based global leader of supply chain risk management for Marsh.

He took RMIA conference delegates through methodologies to change from static to integrated strategies to manage supply chain risk.

"Every organisation, without exception, is part of a supply chain. Organisations now operate in a world of increased upstream and downstream risks in their supply chains," he said.

"Those risks are magnified by the rapid deployment and modularisation of networks



Gary S. Lynch

and targeted cost-cutting in a constrained economy.

"In an interconnected world, supply chains also create single points of exposure to regional and global risks."

Mr Lynch says all organisations must examine their supply chains to identify potential points of failure. They must first consider which products create most value for the organisation and prioritise those.

The last decade has seen dramatic changes in supply chains, particularly as more logistics are outsourced to third parties and greater interdependencies have been created.

Organisations need to know their business partners and supply chain participants very well. "Empower them, provide incentives and let them know what you need," Mr Lynch said.

Organisations need to understand the importance of brand RM and ensure all supply chain participants are well aware of the importance of brand.

Mr Lynch warned that organisations could not assume other participants in the supply chain were adequately managing risk.

Even if an organisation was in the middle of a chain and had no ability to audit other parties, they could still mitigate risk by picking partners who adhered to set criteria and by communicating their expectations clearly, he said.

Three obstacles to sound supply chain RM were a blurred, obstructed view; absence of ownership and unsubstantiated assumptions; and passive monitoring and management.

"Do you know where the aggregation points are in your own supply chain," he asked. "Failure can lead to systemic risk."

While risk managers were aware of the need to better manage the supply chain, few knew where to start. He advised risk managers to rationalise their products and consider which had the most value.

"Focus on the structure around the flow of product, cash and information. You can't bite the whole apple, so start with sections of it.

"Who are your customers and what are their supply chain expectations?"

Mr Lynch said companies could then prioritise impact and investment requirements and develop a shortlist of critical infrastructure required to manage the supply chain for the key product.

GI industry weathers GFC

The general insurance industry's robust regulatory framework and expertise in understanding, evaluating and quantifying risk was behind its ability to better weather the GFC than many organisations in other industries, says Kai Dwyer, head of global corporate for Zurich Financial Services Australia.

He told the RMIA conference insurers had taken write downs on assets and had diminished returns, but the "dull, staid insurers have maintained fitness and low-cost access to contingent capital remains".

Insurers understood the need to provide for future liabilities with asset reserves. IBNRs and provisions for adverse development sat on insurers' balance sheets and the industry insisted on sign off by external actuaries.

The general insurance industry "doesn't wait for regulators to draw the boundaries".

Mr Dwyer said there was a tendency to rely on regulators to solve problems, but organisations had to be prepared for "perils that are out of their control".

While recessions were a natural correction, the GFC's major impact occurred because the interconnectedness created by globalisation and the leverage of debt were misunderstood. "Nobody joined the dots," Mr Dwyer said.

There were flawed RM models, inadequate RM processes and a lack of RM culture.

Post-GFC, there were "goners, survivors and thrivers". The general insurance industry was a thriver, because it understood the aggregation of risk.

Insurers were used to providing for catastrophic losses, using the simple model of exposure, ie, how many eggs are in the basket, plus accumulation, ie, what's the value of those eggs? What's the probable maximum loss?

"It's not yet a perfect model, but we spend a lot of time developing it."

Mr Dwyer predicted a more cautious world in future, with consumers, regulators and market analysts showing little tolerance for investment bankers with "rock star images", many of whom had "left the game".

Cost-less risk transfers created an incentive for "immoral behaviour".

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For example, in the US sub-prime market, “moral hazard ran amok” and there was “voracious hunger” for packaged securitised assets. Loans were not properly underwritten. Bonuses were paid for fee growth created by risky behaviour.

By comparison, the insurance industry had the “compelling logic” of risk retention. Co-insurance, via deductibles, encouraged less risky behaviour.

The CDO market, in which none of the risk was borne by the risk originators, could have used the insurance industry principle of a minimum level of risk retention. For example, the higher the retained portion, the higher the CDO's rating. But the CDO market mismanaged its exposures by failing to evaluate worst-case scenarios.

Manage fatigue or face liability

Fatigue RM is vital for organisations operating 24/7 to improve employee well being and avoid liability, says Bill Sirois, senior vice-president and chief operating officer of Boston, USA-based Circadian Technologies Inc.

He told the RMA conference companies that operated around the clock put employees at “tremendous disadvantage”.

Shift work created physical stress and social conflict that diminished quality of life and increased health and safety risks. Negative impacts for companies included increased staff turnover, absenteeism and higher health costs.

The human body was not designed to function 24/7. It was active and functional by day and hardwired to sleep at night.

Mr Sirois said fatigue caused human error, with subsequent incidents creating high costs and potential liability.

The US was seeing an increase in liability actions taken after shiftworkers had been killed driving home from work.

Tired people could have the same inability to perform as someone who was intoxicated. Fatigue-related human error was a physiological not a behavioural problem, he said.

The core body temperature dropped at night and rose rapidly before dawn, which was the time of maximum fatigue. Mr Sirois said most transport and industrial incidents occurred between 3am and 5am.

Human alertness was “up and down like a toilet seat over a 24-hour period”.

However, he said there were risk management methodologies to mitigate the potential impact of shiftwork.

They began with an assessment of existing policies, practices and procedures – many of which could be counterproductive.

Appropriate staffing levels and changing schedules to ensure employees received adequate sleep were risk mitigation techniques that could be implemented. Organisations need to alleviate burdens that inhibited human performance, he said.

Attitude was also to blame. People who worked long hours and double shifts were seen as “heroic”. Fatigue was cumulative; 50-55 hours of work in a week was “the tipping point”, after which productivity dropped.

Sleep disorders were “rampant” among shiftworkers, but organisations could implement programs to overcome them, which must then be measured, monitored and tracked.

A worker must come to work fully rested, fit for duty, alert and able to sustain that for a full shift of eight, 10 or 12 hours.

Mr Sirois said the length of a shift was not the over-riding factor, but the time at which the shift was performed.

Many workers performed better with longer, but fewer shifts in a working week, because there was less cumulative fatigue.

An extensive “toolbox” included training and education, employee screening, optimising staff levels, collecting and analysing data, and using change management processes.

Fatigue RM needed to become a core priority. Currently it was “undervalued and largely unaddressed”, Mr Sirois said.



Bill Sirois

D&O now 'a quagmire'

D&O cover has expanded from its original purpose to become “a quagmire of corporate cover” which may place those the cover was originally intended to insure at “a distinct disadvantage”.

That's the view of Alistair Sandilands, Ace Australia's corporate manager D&O. He told the RMA conference D&O cover had “a faltering start”, with one 19th century insurer declaring it “immoral”. In the 1960s, it was issued as personal financial protection cover, but had since become a more complex corporate product.

Side A cover indemnified directors and officers for claims and costs, side B reimbursed the company for its indemnification of insured persons and side C covered the entity itself, not the insured persons, for securities claims.

Mr Sandilands said the problem was that the limit was aggregated across all three sides and “the more of the limit that's taken by the company, the less that's available for directors”.

Side C was introduced to “get around the conflict of both the company and the directors being sued”.

It originated in the US, where directors were usually sued first and therefore got “first dibs” on the policy. In Australia, however, it was easier to sue the company, which therefore got the first grab at the D&O limits.

Side C did not “import well” but was “darn difficult to get rid of”.

Often insureds did not want to relinquish it for fear of being criticised and it was frequently offered for no additional premium. Since the High Court's *Fostiff* decision, “a lot of insurers are concerned they will have to write cheques for side C”.

But insurers feared eroded market share if they didn't provide it.

Mr Sandilands said he was “not convinced” enough directors were aware of the potential erosion of D&O cover by the company. “Few directors read the policy or the deeds of indemnification. Policies are not the same, you must go into the detail to understand them,” he said.

An AICD 2009 survey of ASX 200 directors showed 78% of respondents made more conservative business decisions because they feared personal liability and 71% had declined board positions for that reason.

RMIA Update

RMIA AGM MARCH 19, 2010

RMIA's annual general meeting is scheduled for March 19. The board urges all members to take advantage of the opportunity to contribute essential business skills to the institution by nominating for a board position.

There are currently five member-elected directors, one of whom retires in 2010. The RMIA Constitution allows for up to seven directors. Details of how to nominate will be emailed to members soon.

STUDENT AWARD GOES TO MONGOLIA

The Prof Peter Pope memorial award for the best student in a masters level RM course went to Khulan Altangerel, from Mongolia.

RMIA president Brian Roylett, announcing the award at the RMIA conference, said her win showed Australia was recognised as a global leader in RM education.

NEW RM STANDARD ISO 31000 APPROVED

Standards Australia has released a new edition of the RM Standard, following the release of the first international standard to assist executives in managing risk effectively.

AS/NZS ISO 31000-2009 RM – Principles and Guidelines replaces AS/NZS 4360-2004 RM as the leading resource available to Australian directors, top-level executives and others responsible for managing an organisation's risks and achieving objectives.

AS/NZS ISO 31000 is based significantly on the 2004 edition of the Australian/New Zealand RM Standard.

The new standard provides organisations with guiding principles, a generic framework and a process for managing risk. New to this edition is the inclusion of 11 RM principles an organisation should comply with and a management framework for the effective implementation and integration of the principles into an organisation's management system.

The new edition emphasises that risk is the effect of uncertainty on objectives, not just an event.

The new standard is available from Standards Australia's distributor, SAI Global.

A further series of one-day workshops,

Transitioning to the New RM Standard, will be held in 2010.

The content was developed by Kevin Knight AM, RMIA director and convenor of the ISO Working Group on RM that developed the standard.

Workshops are also available in-house, special rates apply. Expressions of interest in workshops for Wellington and Auckland, NZ, are welcome. For more information, email msc@rmia.org.au.

YEARBOOK FOR MEMBERS

Following the successful release of the RMIA Best Practice 2009 Yearbook, a new version is planned for 2010. RMIA is seeking expressions of interest for sponsorship and contributions of technical papers.

Email msc@rmia.org.au for more information.

CPRM/CRMT ASSESSMENT DATES

RMIA members seeking accreditation as a Certified Practising Risk Manager (CPRM) or Certified Risk Management Technician (CRMT) need to book an accreditation assessment. New dates will be finalised soon. For more information, email education@rmia.org.au.

CPRM: Portfolio submissions are required six weeks before the assessment date.

CRMT: Interviews are conducted via a teleconference. Portfolio submissions are required four weeks before the assessment date.

CPRM/CRMT ACCREDITATIONS

RMIA congratulates the following people who have achieved CPRM accreditation, subject to formal approval at a professional standards committee meeting on December 15:

Will Allan ACT Tracy Destree WA
Caroline James WA Ivan Lee NZ
Greg Trivett Qld

FUNDAMENTALS OF MANAGING RISK WORKSHOPS

Participants who attend the Fundamentals of Managing Risk workshop acquire the skills and knowledge to apply the RM process in their organisation.

A new series of workshops will be scheduled in 2010.

Workshops are also available in-house, special rates apply. Expressions of interest in workshops for Wellington and Auckland, NZ, are welcome. For more information, email msc@rmia.org.au.

RMIA 2010 ANNUAL CONFERENCE

The call for papers will soon be announced for the 2010 RMIA annual conference in Sydney. More details soon.

NOMINATE NOW FOR RMOY AWARD

RMIA encourages its members to nominate for the annual Risk Manager of the Year award. Applications will open soon.

RMIA this year took the unprecedented step of not selecting a RMOY.

Peter Brass, finance director and the board member responsible for the award, said the award signified excellence in RM.

The judging panel had had "robust discussions" after interviews with each of the finalists but had been unable to select a clear winner.

While the decision was "disappointing" for the shortlisted candidates, the panel thought it important to "preserve the integrity of the award", he said.

SRMBOK EDITION 1 NOW AVAILABLE AT DISCOUNT RATES FOR BULK PURCHASES

The Security Risk Management Body of Knowledge (SRMBOK) is a holistic, international benchmark for SRM that allows application of existing security and risk frameworks in a consistent, meaningful manner.

RMIA is offering a discount to members for bulk purchases of SRMBOK Edition 1. Copies are selling fast, so place your order now.

Members can buy individual copies for \$125 (incl GST) or a box of 16 for \$1,600 (incl GST). If you buy 100 or more copies, they are only \$80 each (incl GST) (\$8,000/100 copies). Postage & handling fees apply.

Email membership@rmia.org.au to place your order.

Non-members can also access a special price. The non-member price is \$150 (incl GST), plus postage & handling fees.

RMIA CONFERENCE PHOTOS

All photographs included in this issue are by Murray Harris.

To purchase a CD of social shots or speakers from the RMIA conference, go to www.murrayharris.com.au and click client viewing.

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