

RISK HORIZONS

Global forum highlights need to return to core risks

The global financial crisis has changed the shape of risk management, a panel of experts has agreed.

Professor George Cairns, from RMIT University, NASA's Mike Lutomski, Gareth Shepherd and Nicholas Davis, from the World Economic Forum, Aon's Paul Venning, Marsh USA's John Merkovsky, Marsh Asia Pacific's David Bidmead and Craig Jackson, from Ernst & Young, participated in a panel session moderated by Lee Lin Chin, from SBS, during the annual RMA conference in Perth, WA.

Mr Venning said risk was now at the forefront and that was a good thing for RMA. The global situation meant organisations were returning to core risks to gain competitive advantage.

They would face increased regulation and greater oversight by rating agencies. The financial crisis also meant some risks, like climate change and ID theft, were "taking a back seat".

He asked whether businesses were properly set up to manage risk, and suggested "probably not".

Mr Merkovsky predicted risk managers would spend too much time on "the headline risks" and not enough on their own business models. "We must bulletproof our businesses."

He did not see the financial crisis as indicative of a failure of risk management, saying risk management had "done what it should".

Risk managers had warned of the "excess assets in some sectors". But he said perhaps they should have seen CEO compensation models as a risk.

Good risk managers "know when to hit the brakes", but organisations' infrastructures have developed a "hit-the-gas attitude".

Dr Shepherd said it was "not until the tide goes out that you notice you have been swimming

naked". The financial crisis had "discovered people swimming naked and it's not pretty". However, he warned risk managers not to "get caught up in the thought that life as we know it is over. The last 20 years have been the most prosperous for the last 200 years. We must keep it in context". Historically, although everyone thought they were "doomed" during a crisis, afterwards they thought "perhaps it was not so bad after all".

He likened the global financial crisis to "timber building up on the forest floor. If we postpone the clearing process, a fire can get out of hand very quickly".

He said panics and crises were "part of capitalism and we must adapt". Business adopted the "cockroach approach. We scuttle away, but we eventually come back".

Mr Bidmead said diversifying risk was important to weather the crisis. He warned against neglecting emerging risks, like climate change and pandemics, because of the "significant threats on the doorstep".

Mr Lutomski sounded a similar warning, saying if the sub-prime mortgage market had caused such dire problems in the financial world,

consider the potential impact if climate change threatened drinking water supplies. "We need more robust financial systems for when the really big problems occur."

On CEO salaries, Mr Bidmead said there was miscommunication

between action and output. "When you are consistently successful in generating huge amounts of money and they pay you a lot to do it, you will do it more".

CEOs got "drunk on the notion" and there was less understanding of where "acceptable behaviour starts and ends".

Mr Davis agreed, saying the problem was a short-term focus instead of remuneration and incentives being linked to long-term results. "There's no ethics in market behaviour; it's supply and demand."

He said no one could pretend to know the future, but WEF was making predictions and forecasts and its scenario planning team was "seeking to make uncertainties more explicit. We try to imagine multiple, different futures". He said WEF was concerned about spiralling leveraging and had spoken to CEOs about it, but perhaps it "takes a major crisis to get everyone back on the same page".

Mr Jackson said the global financial crisis forced businesses to focus on risk management. "Risk management must be owned by the CEO and management team."

"Risk management must be integrated across the organisation. Focus not on myriad risks, but those that really matter.

Drill down into them."

He warned that getting too involved in "the big picture" meant risk managers stopped focusing on risks in their own sector or business. "Focus on the things you can control."

He said risk professionals had to "step up and get more engaged with the decision-makers". Frequently those managing a business thought they could manage risk intuitively.

Organisations whose cultures encouraged challenges were "a good thing" because that meant the attitude was not "just go with the flow".

Prof Cairns said governments had a duty to look after communities' health and security, but had abrogated those interests in favour of the interests of capitalism. Multinationals had "bypassed government to conduct business globally".

'Focus on things you can control'

'Big risks take a back seat'

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Tough times are likely to get tougher

Increased regulation, falling demand and a continuing shift towards Asia are all likely as the world financial crisis intensifies, says Lowy Institute international economy program director Mark Thirlwell.

Speaking at a Marsh-sponsored breakfast at the RMA annual conference in Perth, Mr Thirlwell said the world economy was being put through one of the most significant "stress tests" since the end of the World War Two.

"It's almost like we've had some sort of divine economist or divine risk manager sitting up there in the heavens who looked down at the world economy at the start of 2008 and said, right, I'm really going to stress test this."



Mark Thirlwell

An economic comeback looked more likely than it did in the 1940s, but the world political risk environment "looks pretty frightening", he said.

Before the economic collapse, many regulatory bodies and central banks around the world had proponents of free-market ideology at the helm, but that would have to change, Mr Thirlwell said.

"You don't appoint pacifists to run the US marine core, and you don't appoint believers in non-regulation or de-regulation, to run the regulatory system."

The most likely international political response, particularly after the election of Barack Obama as US president, was an increase in regulation, he said.

"The model of deregulation and self regulation has taken a huge blow to its credibility. There will be far less self regulation. We are now looking at a re-regulation process."

For producers and exporters, the flow-on effects of falling consumer demand would become particularly troublesome in coming months.

It would be harder for businesses to gather investors when demand was low and product prices dropped, Mr Thirlwell said.

"Over the next several years, the price signals we need [to foster investment] are going to go the wrong way. It's hard enough to do during boom times, even harder to do during tough times."

The economic slowdown was also likely to "reinforce" the shift in economic and political power towards Asia. There could be some opposition to that shift initially, as governments urged consumers to buy products nationally, but the West was already so reliant on products manufactured in Asia that the resistance would not last long.

"A good example of this is that, a year or so ago, we had a series of food scares and product scares coming out of China and people were saying... don't buy children's toys if they have 'made in China' printed on them. My response to that is, have you ever tried to buy a child's toy that doesn't have 'made in China' on it?"

Other impacts of the economic slowdown, long term, included increasing inflation and increasing opposition to globalisation.

Those countries that would most feel the pinch were smaller, developed countries that had large trade deficits and a heavy reliance on imported goods, Mr Thirlwell said.

In a Q&A session with Marsh Asia Pacific's David Bidmead, Mr Thirlwell said he had "no specialist expertise" on Australia, but a potential negative was the nation being a major commodity exporter. "Large external debt is seen as a risk indicator. But our shock absorbers are in pretty good shape."

He said the Australian Government's decision to spend \$6 billion on the car industry was "shocking". But governments were walking a tightrope. They had to prepare people for deficits, but without scaring them.

Enhance "risk consciousness"

Risk managers need to "enhance" their "risk consciousness, says John Merkovsky, global managing director of Marsh Risk Consulting, USA.

He told the RMA conference that risk managers needed to focus on risks within their own organisations, rather than the external risk environment. "We have seen businesses spend

enormous sums on attempts to bulletproof organisations against risk without really identifying how those risks might affect them."

He told risk managers to identify what was important to the success of the organisation. For example, specific product lines, highly trained personnel, a particular customer base, a transport hub or path, an outsourced location or a proprietary process or technology. He gave the example of a coal company that relied on a single railroad. "Why spend money on other risks if that one's not nailed down? Without it, the business would be out of business."

Setting risk priorities should not be prescriptive. "There are subjective elements involved. You need to think about non-quantifiable risks, not just the quantifiable."

Risk registers should be based on business objectives, but often the two were not aligned.

Mr Merkovsky said some risk registers were based on the likeliest risks, the ones most feared or those easiest to mitigate. "We have seen organisations that list 50 risks as critical, but there should only be a handful. The risk spend should be on those risks that are most important to the organisation."

He warned that dependencies may be unintentional, for example, a supplier's supplier. "Failure of dependencies can have far-reaching impacts on reputation, revenue, operational continuity, customer satisfaction and customer retention."

Enhanced risk management needed to be owned at the c-suite level and risk factored into important business changes before they occurred, not after. Too often, risk management was "a 'bolt on' to something already built".

Risk managers needed to understand "the inner workings" of their organisation and what affected the CEO to "get a place at the top table". He advised against speaking in risk management jargon, saying "you must be relevant to [senior executives'] priorities".



John Merkovsky

RMIA announces Risk Manager of the Year

Leighton Holdings Ltd's executive general manager, risk management, David Hudson, is RMIA's 2008 Risk Manager of the Year.



David Lamb (right) presents David Hudson with his award.

The award was announced at the RMIA conference in Perth, WA. Mr Hudson said it was "a very high honour" to receive such an award from one's peers.

"Risk management is team work at Leighton Holdings. There are countless frontline people at the Leighton sites doing risk management daily, and they are the true winners," he said.

Leighton Holdings is the parent company of Australia's largest project development and contracting group.

It has six subsidiaries and employs 30,000 people in more than 20 countries on diverse building, civil engineering, infrastructure construction, mining and services projects for public and private sector clients.

Since 2004, Leighton has built a well-established project risk management process throughout the group to actively implement initiatives to better identify, mitigate and respond to potential threats.

The RMIA judging panel selected Mr Hudson as the RMOY recipient in acknowledgement of the leadership, technical and management expertise, he and his team have demonstrated.

Mr Hudson has driven risk management initiatives to achieve:

- More consistent project outcomes, compared to budget, that has contributed to improved group profitability;
- A reduced financial risk profile by lowering the group's dependence on hard-dollar risk transfer projects and improved conditions

through enhanced client, stakeholder and market trust in the group's ability to manage risk;

- Competitive advantage and a trend of lower insurance premium costs;
- New guidelines to identify significant business and strategic risks and opportunities to the board and group executive;
- Establishment of a Risk Management Working Group to promote professional development within Leighton Group and to benchmark and influence implementation of best practice in the risk discipline; and
- Industry leadership through representation on and presentations to professional improvement bodies, including RMIA's Risk Leadership Perspectives breakfast seminar series.

RMIA immediate past president Grant Whitehorn said: "Mr Hudson is a very worthy recipient of the 2008 Risk Manager of the Year Award because of his considerable achievements in advancing risk management within his own company and more broadly to industry and business."

David Lamb, AIG Australasia regional manager, major accounts practice, presented the award.

Gas shortage tests risk management processes

Alcoa's response to Western Australia's natural gas shortages after the June explosion on Varanus Island demonstrated the effectiveness of its risk management programs, says an Alcoa executive.

Tom Adams, executive director, finance & business services, Alcoa Australia, told the RMIA conference that Alcoa had diesel back up and risk assessment processes in place.

"We lost only a small fraction of production, despite getting a third of our gas from Apache," operator of the Varanus Island plant. During the crisis, Alcoa had a "daily war room" established to continually monitor the impacts.

Alcoa operates 10 sites in WA, NSW and Victoria. It mines 8.7 million tonnes of alumina a year, most of which is exported. It produces 548,000 tonnes of aluminium a year.

Mr Adams said governance and risk management were "the foundation of the business model" at Alcoa.

The company had considered potential risks and noted them on its risk register. They included

water supply, port blockages, pandemics, carbon tax risks, gas supply interruption, rail network unavailability, the skills shortage and delivery of global raw materials.

Risks were reassessed annually. "We drill down into all levels of the business," Mr Adams said.

The environment was a key risk for Alcoa. It mines bauxite in "Perth's backyard". "Our mining operations are right next door to significant populations."

Alcoa had achieved its target of a 25% reduction in greenhouse gas emissions from 1990 levels by 2003, ahead of its 2010 target. Mr Adams said Alcoa was in favour of an emissions trading scheme (ETS), but only on a global basis, "not Australia on its own".

Otherwise industries would move to China, a country that required "two to three times the energy to produce the same amount of alumina". As an energy-intensive industry, Alcoa would pay heavily for an ETS.

Mr Adams said the company was "pushing risk minimisation strategies, including making sure the decision-makers are aware of the impact for us".

The global financial crisis had had a major impact, with the aluminium price on the London Metal Exchange dropping from more than \$3,000/tonne to less than \$2,500/tonne.

That had forced Alcoa to put some capital expansions on hold. It was also using risk management processes to reassess inventory. "Reducing inventory is cash in the bank," he said.

Asked about alternative energy sources, Mr Adams said Alcoa had a wind farm at its Portland smelter. "The problem is, if it's not windy or sunny, we can't stop operating." Wind or solar energy was therefore unsuitable for baseload power.

Alcoa was looking at opportunities for geothermal power and co-generation, including capturing secondary steam. It was also seeking to make its operations more efficient. However, Mr Adams said "the technology's not there yet".



Tom Adams

RMIA Update

by Marilyn Forde
RMIA CEO



RMIA APPOINTS NEW PRESIDENT

Brian Roylett is the new president of the Risk Management Institution of Australasia. Mr Roylett, whose appointment was announced at the RMIA annual general meeting in Perth, WA, is the principal of Perth-based Roylett Risk Management Pty Ltd (RRM).

He replaces Grant Whitehorn. Before establishing RRM in 2006, Mr Roylett was national manager, self-insurance services, for Insurance Australia Group Ltd.

The new vice-president is Peter Napier, risk manager at Ipswich City Council, Queensland, and the finance director is Peter Brass, risk manager with South Australia's Department of Primary Industries & Resources.

Mr Roylett was chairman of the RMIA conference committee for the annual conference, themed *Risk Management, Delivering Business Opportunities*, held at the Perth Convention Centre on November 16-19.

Former finance director Kevin Mutch and director Peter Hanzlicek have retired from the board. RMIA thanks them both for their commitment to the organisation as volunteers over many years.



RMIA CONFERENCE AN OUTSTANDING SUCCESS

The 2008 RMIA conference in Perth, WA, was an excellent success, with about 650 delegates, exhibitors and partners registered.

Many thanks to all those who participated as speakers, session chairs, moderators, exhibitors and delegates. In particular, thanks to members of the conference committee, headed by Brian Roylett. Other members were Grant Whitehorn, Peter Brass, Peter Napier, Margaret Hemsley, Chris Douglas, Julianne Foley, Denise Kafkalakis, Gavin Moreira and myself.



Season's Greetings

The RMIA Corporate Office wishes all members a safe and happy festive season.

Many thanks to all the directors and chapter and SIG executives who have worked hard throughout 2008 to ensure RMIA delivers a high standard of member services.

The presentations were high quality, thought provoking and frequently entertaining. The social events were an excellent opportunity to network and make social connections that can last a lifetime.

Photographs taken by RMIA's official photographer, Murray Harris, are available. Go to www.murrayharris.com.au to buy a CD of the photos. Go to Client Viewing/RMIA conference. Photos that appeared in the daily conference newspaper can be downloaded at www.BIEurope.com/RMIA



CAIRNS CONFERENCE – CALL FOR PAPERS

The call for papers for the 2009 RMIA conference in Cairns, north Queensland, has opened. For more information, go to www.rmia.org.au.

The Cairns conference is scheduled for November 22-25, 2009, so mark your diaries now.



RMIA ANNOUNCES STUDENT OF THE YEAR

Bruce McAsey has received the RMIA student of the year Professor Peter Pope Memorial Award for achieving the highest grade point average of any student in Monash University's graduate certificate in risk management program.

Mr McAsey works in the disability program area of Victoria's Department of Human Services.



Former president Grant Whitehorn (left) and RMIA director Peter Brass congratulate Bruce McAsey on his outstanding result.

In 2002, he became project manager for hazard management, specifically fire risk management, for disability program-funded services.

Being concerned to ensure the role was not an administrative form-filling exercise focusing on risk aversion, he began the Master of Risk Management at Monash in 2003 and graduated in October 2008.



CPRMs/CRMTs HONOURED AT CONFERENCE

RMIA's CPRM and CRMT recipients were honoured at the RMIA conference.

Their achievements in gaining these accreditations are considerable.

The conference was preceded by a CPRM master class, and many master class participants worked hard to develop a paper from the class to present during the conference, with the assistance of workshop facilitator Prof George Cairns, from RMIT University.



EXPRESSIONS OF INTEREST – PROFESSIONAL DEVELOPMENT

RMIA is always keen to hear expressions of interest from people suitably qualified to present the Fundamentals of Managing Risk Workshops, which will continue throughout 2009. Email education@rmia.org.au.

Members who are qualified to present professional development sessions on other topics should also contact Education Manager Denise Kafkalakis on education@rmia.org.au. RMIA is keen to have a variety of speakers/presenters available for its professional development events.



SPECIAL CONFERENCE ISSUE

This issue of *Risk Horizons* is the first of two special issues to share presentations from the RMIA conference in Perth with members.

The next issue will be emailed to members in mid-January, 2009.

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