

REGULATORY INTELLIGENCE

Understanding connected business exposure

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The business world is increasingly connected through direct and indirect relationships, coupling businesses together in tightly interwoven networks within which both opportunity and risk flow.

This exposes business to what the author terms "connected business exposure", which can be defined as "the systemic impact on commercial organisations, their partners, suppliers and clients from cumulative and cascading financial, operational and reputational fluctuations and uncertainties".



When an event occurs, whether it be a major storm, the financial failure of a leading customer, a change in regulation or a cyber attack on a key supplier, that event not only affects an organisation but also has connected consequences for the many companies involved in its trading network. Conversely, these connections can be used as new routes to market, because it may be more efficient for an organisation to leverage existing connections to maximise the opportunities that data offers when understanding emerging interdependencies between corporates and their partners in risk.

Insurers, for example, because of their siloed focus on product classes, struggle to deal with the contagion fallout from such events, which cut across and beyond their classes of business and move throughout the insurance value chain, exposing insurers, reinsurers and, in turn, their reinsurers (the retrocession market).

Retrocession is a type of reinsurance wherein a reinsurance company takes on part of the risk assumed by another reinsurance company. Rather like reinsurance, retrocession also aims to reduce risk and the liability burden of the initial reinsurer by spreading out the risk to other reinsurance companies. Such practices go back more than a hundred years but, in the past, have spiralled out of

control, causing contagion that threatened the existence of an entire insurance market. One example was Lloyd's of London during the 1990s, which was almost brought to its knees by a combination of the Piper Alpha incident and the asbestos crisis.

Meanwhile, corporates also recognise that they are siloed by function (for example, treasury, procurement, marketing, risk and finance). When an event affects a corporate, therefore, it can do so on multiple levels, some of which it might not even be aware of. For example, a corporate might not immediately realise that a customer is also a supplier to the business, an investor in the business and even someone they themselves invest in through their pension fund. Just like an insurer, therefore, a corporate needs to understand its exposure across the entire organisation.

That knowledge not only helps to understand risk and build resilience into an organisation but it also helps to identify areas of opportunity. For example, identifying new routes to market or even new markets themselves, and being able to utilise fully the strengths of the global partner profile that constitutes their whole business portfolio. This applies equally to corporates, their insurers and financiers.

Only 20% of most corporate risk is insurable, and risks are becoming more interconnected and time-critical in today's digital world. It is crucial, therefore, for insurers to re-evaluate the siloed nature of their own exposure knowledge if they are to continue to meet the ultimate needs of corporate clients, while developing new risk transfer mechanisms that meet their changing needs. To help understand connected business exposure, the Russell Group, a risk management software and services company of which the author is the founder and managing director, has developed a new risk/opportunity scoring mechanism.

The Russell Score

The Russell Group has created as a starting point a new risk universe which includes more than 65,000 companies and their subsidiaries which, collectively, represent 42% of all global company revenue.

The aim is to apply a score to each company in this universe. The score is formulated from a matrix of four dimensions representing financial, product/service, people and location attributes of a company.

The Russell Score is derived by calculating a metric which would include a company's inside-out exposure and its partner, client and supplier linked relationships, thus enabling an outside-in and inside-out view to be taken. The thinking behind this was to enable the score to respond sooner if an organisation experiences some monitored change either internally or externally within its network of linked relationships.

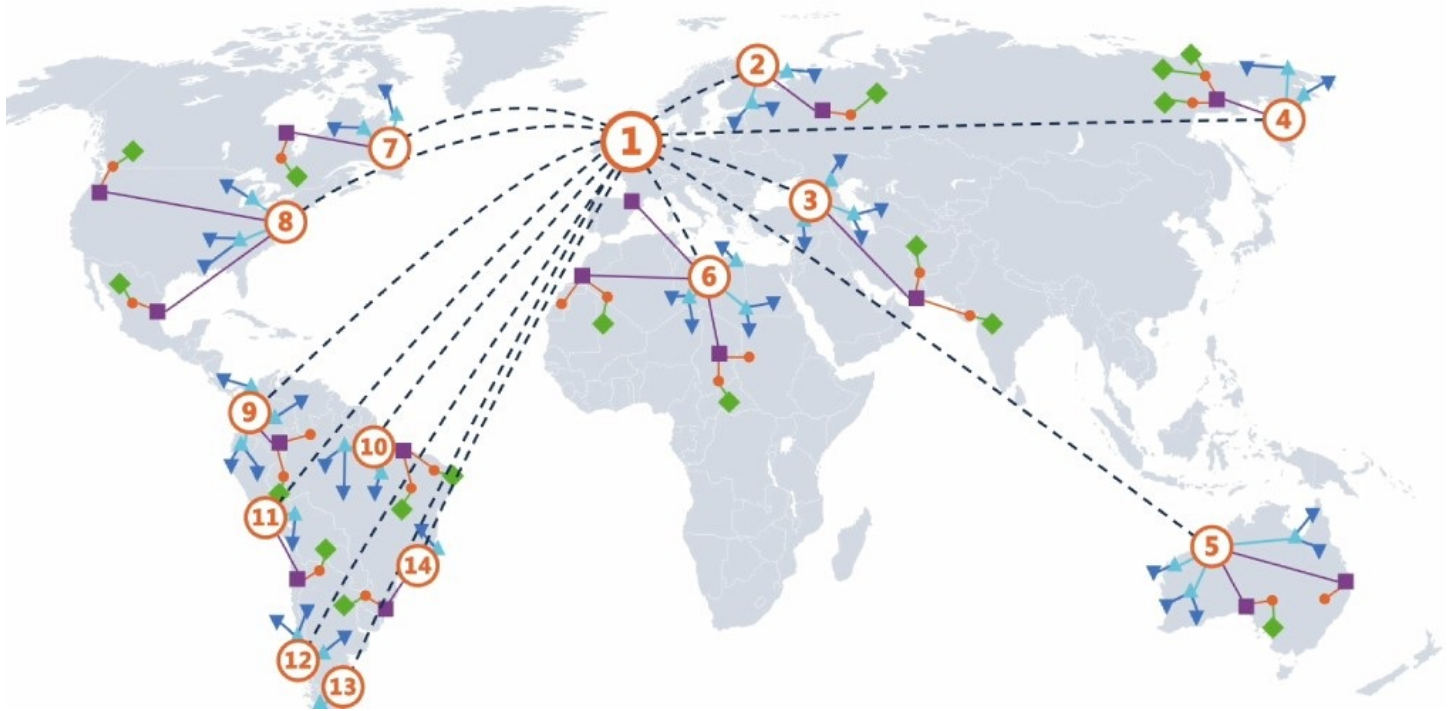
This would give decision-makers advance notice of positive and negative signals within their company network and enable appropriate decisions to be made sooner. The scoring algorithm uses the existing Russell Universe to construct nodes and edges in each organisation's trading network. This enables "pinch-points" in the network to be quickly realised and establishes a framework for detailed realistic disaster scenarios to be performed and an overall score for each organisation to be calculated.

The knowledge gleaned from this universe will, when applied to an organisation's own landscape, enhance strategic decision-making throughout the enterprise and help with portfolio concentration and diversification opportunities.



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As with most industries that are connected and rely on technology, the risk management and insurance industries face considerable challenges and opportunities. Data-powered online capabilities offer new ways to engage customers, connecting internal processes and "outside-in" risk drivers to improve risk assessment. Greater competition, along with economic, political, regulatory, and climate uncertainty, add to the pressure to operate more effectively and strategically.

As risk management and insurance providers seek to stand out in an increasingly crowded field, technology is a crucial part of maintaining a competitive edge.

Successful risk management professionals must process transactions in real time. They must also be able to scale their capacity quickly to meet usage growth, e.g., new products. They also need connected capabilities and sophisticated analytics to help them quickly monitor and analyse the many data streams that are now relevant to their business.

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