SPECIAL
REPORT

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Through The Looking Glass - Russell Group Roundtable

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Black Mirror Moments Reflect Risk Managers' Unease at Pace of Change

Embracing ferocious technological change, engaging inert boardrooms and honing the skills sets of future risk managers all came to the fore at a special Russell Group roundtable discussion.

Held in association with StrategicRISK magazine at the International Convention Centre, Birmingham during the annual Airmic conference, the Interconnectedness of Risk looked at specific risk exposures and how they relate to each other.

The event brought senior executives from the agriculture and chemicals, automotive, and utilities industries together with risk managers, leading insurers and consultants to assess how companies are coping with the increasingly complex risks to supply chains, business interruption, their boardrooms and overall reputations.

With Sophie Roberts, Associate Publisher, StrategicRISK, managing the roundtable, the initial, fundamental question was one of definition. Colin Barker, Deputy Company Secretary at Bayer PLC, defined interconnected risk simply. 'To me it's like the domino effect,' he said, 'so one impact will cause a reaction to something else, so therefore it's interconnected. Any contingent risk from one action into another is a connected risk.'

Group Risk Manager at engineering consultancy Ricardo, Andrew Swayne, concurred, adding his firm's tendency to collaborate inter-departmentally. 'The way we structure our risk register and our risk thinking is we don't put things in silos, we obviously have to have a label, but there is a lot of cross-referencing going around and we sort our risks by type and the drivers going around them so we can see the actions, put them together and review them as a package.'

For general insurer RSA's Neil Strickland, Director, Global Consulting, the complexity of supply chains was instrumental in understanding the meaning of the issue. He said: 'If you look at the industry as a whole, the supply chain's becoming much more complex because boards are demanding we operate just-in-time which plays out to the same, but more complex risks. It's very difficult to nail it and therefore to insure it, but it brings us back down to basics: any risk is just risk and is all around your business continuity. If you have it in a broad enough sense or plan you can respond to any risk. With interconnected risk, you don't know where it is coming from, or what it will be, so it's all about the basics.'

Allianz Global Corporate & Specialty's UK CEO, Brian Kirwan, stressed correlations as the essence to the issue. He explained: 'We are looking at correlations between particular events. For us that's what the interconnectivity of risk is. It's creating a much greater loss than the individual loss. What's changing for us is before where loss would be looked at from a physical location point of view so you could correlate your potential losses per event/per location, software and technology moves that in a much broader way so we have correlations within and across companies. Software is changing the way we have to look at

correlation and interconnectivity.

Reflecting on his experience of supply chain risk 15 years ago, Kirwan explained: ‘Nearly every supplier was based in New York City - because that’s where the billing address was. So that’s where this game started 15 years ago. If you now go to the major car manufacturers, the complexity and mathematics behind supply chain and interconnectivity has dramatically increased. I think that’s where the world is going to go. It’s much more about data, modelling and understanding the connectivity on a mathematical basis.’

Brand impacts arise from hidden, covert agreements and relationships between clients and suppliers which in turn places a huge emphasis on understanding supply chains on multiple levels. As Kirwan elaborated: ‘What data should I be asking from my suppliers? We have one of our clients who said ‘a major manufacturer is asking for all of this data, they’ve never asked us for data before which is probably our fault because we’ve been asking them for data from their suppliers!’ It’s going down the chain. Everyone is asking for more data. How you model the data and how you understand the clauses in the contracts, particularly in the event of a problem where everyone has the same supplier. This is what happened in Tainjin [Hebei, China, August 2015] where everyone had the exact same business continuity with the exact same supplier.’

For event sponsor Russell Group’s MD, Suki Basi, PR, brand value and reputation are all intrinsic to the concept of interconnected risk. As he averred: ‘You’re getting into the interplay of events with intangible assets where brand value and reputation are big. To some extent we are in unchartered territory. To say [interconnected risks] are new, well, they’ve always been there. They are now amplified by the environment we’re in which is faster moving. It is how you react to this rather than the actual risk, such as how you react that forces the share price in one direction or the other which is the biggest measure for brand value and reputation.’

Bored engagement?

There was consensus that the average board cannot look at 25 risk issues at the same time, but typically focus on three priorities that they then instruct their risk managers to stress test. This has proven inadequate, according to Julia Graham, Deputy CEO and Technical Director at the U.K.’s foremost risk management association, Airmic.

Graham lamented: ‘There’s an assumption that boards get involved with this. Our experience

of talking through the Chairman's Forum is they don't. Research that people like McKinsey have done shows how much time boards spend looking at risk – it's about three-and-a-half percent of their time. And it's not changing even though the governance demands on risk are increasing.'

She went on to identify some salient new operating trends. 'One is as new type of governance, where the board can look to people who operate at an integrated level, maybe the level that sits beneath them – because the whole concept of connected risk means you need connected management; with the domino effect scenario, I think it's four-dimensional dominos, because they don't go in a straight line, they go all over the place. The difference with connected risk is that it doesn't work laterally. They're like an amoeba. They go in all sorts of directions, they go in all sorts of dimensions. What you therefore need is not only connected risk assessments, you need connected risk controls.'

Graham stressed the need for new tools and techniques. 'If you look at the FRC code they ask companies now to list their top ten principal risks. That almost encourages people to think in a linear way, in a list. 'List me your top ten'. That doesn't encourage companies to think in an interconnected way. There is something awry with the governance process, albeit it's quite new on the code having only been out a couple of years.'

Airmic's Deputy CEO recalled an historical example of interconnected risk from the housing market crisis of the late 1980s. 'Many years ago when you could have general and life insurance companies – composite companies – together low-cost mortgage endowment policies blew apart because of reductions in interest rates. This had a catastrophic effect on the value of endowment polices to pay your mortgage. If you were an insurance company incentivising your sales team to sell these – and I happened to work for a company that did – it nearly killed us because we never thought to look at the relationship between life in general and the impact of something in the housing market that touched both.

For Graham, the risk itself is not novel; its velocity and viral nature today are. 'Connected risk isn't new. What's new is the context and the environment are much more sophisticated. It's harder. It's more complex. And it's faster and harder to understand.'

The Warranty Group's Managing Partner Patrick Smith opined that finding the tool that tests the engagement of the board was critical. 'In my experience finding a tool that worked was due to

a Solvency II implementation. I was really struggling with stress testing and modelling. I wasn't struggling to do it – I know how to do it. But emotionally getting engagement with the answer, that was really hard. What really worked was stress testing. I had to ask the question about twelve times before they understood the question.'

Smith continued: 'It's not 'How likely are we to go wrong. We've gone wrong. How did it happen?' Once they understood that question and addressed that, we didn't really have to talk about risk whatsoever. I just made notes. They were connecting. They were building the scenario of the demise of the organisation. The network of interconnected risk simply emerged. The engagement was that was a legitimate question to ask. The tool was the question: 'You're bust. How did it happen?' Emotionally, that turned the corner.'

Basi highlighted the ripple effect of last September's collapse of South Korea's Hanjin Shipping, where vessels were seized by authorities and creditors, while others were denied entry to ports when the company lost the support of its banks.

'At the time of their bankruptcy, there was obviously cargo shipping all over the planet,' recalled Basi. 'There was no knowledge of where he ships were and in some cases the ships with perishable goods couldn't enter the harbour because the company was in administration pending insolvency. Obviously, shipping's a big part of global trade. That was an example of something that is so key in the global system, it's failure caused so many gaps in information that in itself is a demonstration of the era we're now getting into. As we get more interconnected, these situations are going to became more common. Part of this is that we're cost-driven and are trying to keep things moving and keeping low inventory levels.'

Function over form

Inter-departmental collaboration is a critical method to combat the silo mentaility in companies that can lead to blind spots in which interconnected risk lurks. It's often a challenge to work collaboratively with everyone, it's the way to move forward.

Christopher Palm, Chief Risk Advisor at the Institute of Risk Management South Africa told how he had learnt the hard way over a decade how to bring the board onside. ' My background is in the biggest electricity supply network in South Africa. We told the board 'But we told you about the risks. Why have the 'top ten' risks materialised'? They replied 'Maybe it's about the way you told

us about the risks.' So we started reverse engineering of risk being a linear or a chronological flow of events that you look at from either a process perspective or a functional perspective instead of a value chain, or do you look at it from a 'systems thinking' perspective?'

Palm challenged the methodology, management and board mentality where it came to interconnected risk. He said: 'We have dominoes that fall from five different angles. How do we respond to that?' 'If you have risk affecting finance, but don't have finance expertise around the table, you lose interconnectivity and the whole thought of interconnectedness across the value chain right there. From the source evidence, we've learnt that we get it wrong. If you get it wrong there, you get it wrong straight to the top. The information that we give them – it's a likelihood and a consequence and to do with one particular function or process it stays as that and nobody sees or is able to discuss the systems thinking that you need in that space. So we fixed it at the methodology level.'

Risk managers are never the experts, insisted Palm. 'They are risk managers and they enable and they have a credible process that they sell. They facilitate, like in an orchestra, subject matter experts across the value chain. Every single time, for every single objective. We don't streamline.

'At an executive level' Palm continued, 'where you link risk not just for the sake of a risk register, you now have risks on a consequence level that impact on the same consequence. You also have risks on a likelihood level. Imagine on a time continuum actually where risks seem to get together? Whether they are related by name or by title doesn't matter. Risks themselves also have interconnectivity in terms of their timing. We also found if you could show the board where resources are locked up in controls, the interconnectivity of a control to a risk becomes an issue.'

XL Catlin's Head of Property Engineering, Jonathan Salter, insisted there is a real need to understand the connectivity of the risk. To illustrate his remark, Salter said: 'In automotive, there are, constantly, examples where the lack of, say, a piece of kit in Italy from a supplier means production grinds to a halt in four or five countries. There's lots of high-profile ones that make the media, but I guess the good news is there's lots that don't make the media. People understand the value of connectivity, but also the risk of disruption. There are investing a lot of time in understanding the business, continuity, resilience. It's very difficult to know where these things are going to come from because of the nature of these

'four-dimensional' dominos. It could be a problem with a NatCat event somewhere gives us a production challenge on the other side of the world.'

Skills shortage

Julia Graham pressed the need for a new type of bolder risk manager. 'I would argue that tomorrow's risk managers need different knowledge, different skills, they need different abilities to use data. We've got many members who could use a spreadsheet the size of this table and not bat an eyelid. We've got to be prepared to think of technology in a similar way. It's inexcusable in the future to say 'we don't know anything about these new issues' because that's the world we live in.'

Tomorrow's risk manager needs to be a lot less risk averse and more takers of risk so they can look at opportunity, as well as risk, added Graham. 'They have to be much more willing to work in teams. They have to be great collaborators, negotiators. There's a skilling-up of the profession - which is already happening - so we can have the conversation with insurers. I have a lot of sympathy with insurers because we don't know how to articulate the problem. '

Supermodels on speed

The panel universally agreed that the pace of - especially technological - change is relentless and accelerating. As Kirwan at Allianz commented: 'Our business models are changing dramatically fast. The last conversations I've been having are about big data, data leaks, correlations, mathematical modelling and modelling interconnectivity. We're moving at an astonishing pace as an industry with digitalisation. We see most of our customers' business models changing dramatically fast. The biggest risk to all enterprise at the moment is technological change. You can talk about all the other bits, but your business can go out of business within months of a significant technological change. If you're not adopting the right technology fast enough, you're not going to survive.'

In encapsulating the hard challenge confronting the risk management community in terms of interconnected risk, Basi gave the most telling caveat. He said: 'In terms of modelling that aspect, how can you possibly model the world? Well, you start by the data you need and try to build it layer by layer. But part of it is conceptual in terms of good data capture and good techniques around that so you can begin to start at least modelling parts of the environment.'

As Basi concluded: 'We're picking up on liabilities and 'unknowns' in business and the best way is orientating towards a culture that's more responsive and reactive to change and views risk as an opportunity rather than as a threat. That needs to be the baseline; without that you're always fighting against the ingrained culture. Risk managers are looking at virtual reality now. In terms of role-playing and simulations imagining a virtual reality is perfect because it puts you in the situation. That's a great way of getting management into the situation.'

Russell Group is a leading risk management software and service company that provides a truly integrated risk management platform for corporate risk managers and (re)insurance clients operating in an increasingly connected world.

Connected risk refers to the growth in companies which are increasingly integrating across industrial sectors and geographies, and creating greater levels of risk. This exposes corporates and (re)insurers to a broader range of inter-related perils, which requires a risk management approach built upon deep business intelligence and analytics.

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