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Study of Insurance Economics

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**The Insurance Industry and Enterprise
Risk Management: From Compliance to
Value Creation**

21 November 2007

Milan

&

Uninsured Industrial Risks

Ongoing Research Project
by Tileman Fischer

December 2007

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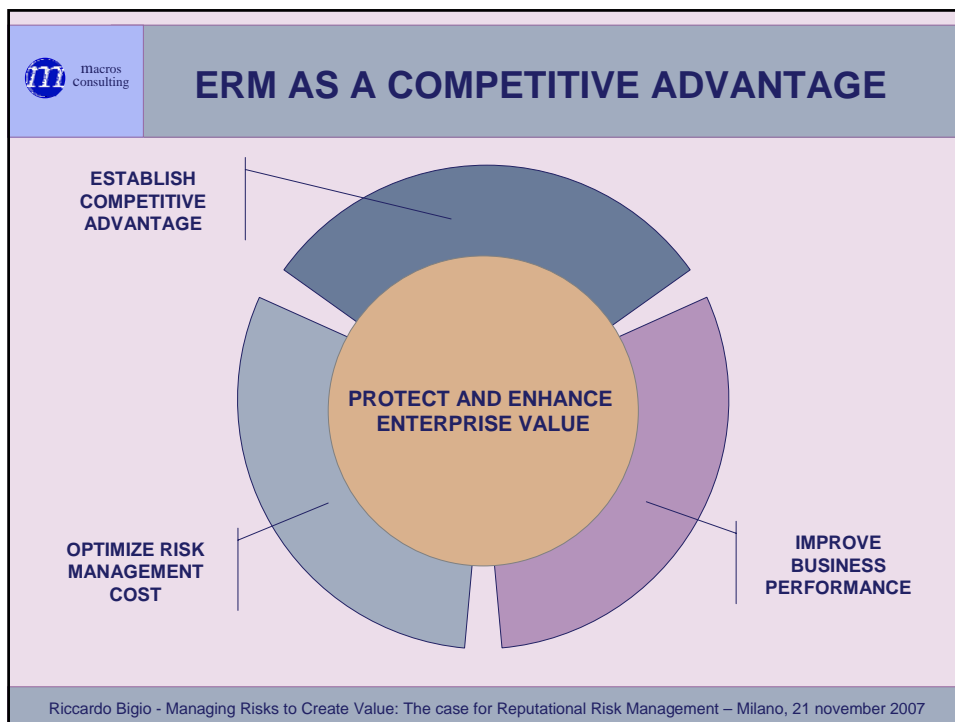
Managing Risks to Create Value: The case of Reputational Risk Management

Riccardo Bigio




AGENDA

- ERM as a Competitive Advantage
- Compliance vs Value Creation
- Risks relevance
- Managing Reputational Risk
- Conclusions



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- ERM AS A COMPETITIVE ADVANTAGE**
- Integrate risk management and strategy setting
 - Improve management of risks across enterprise
 - Improve capital deployment and resource allocation
 - Configure risk taking with core competencies
 - Protect reputation, brand and image
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COMPLIANCE vs VALUE CREATION

- A culture of risk awareness has yet to emerge
- The importance of Governance is underestimated
- Quantifiable risks are still the focus of too much attention

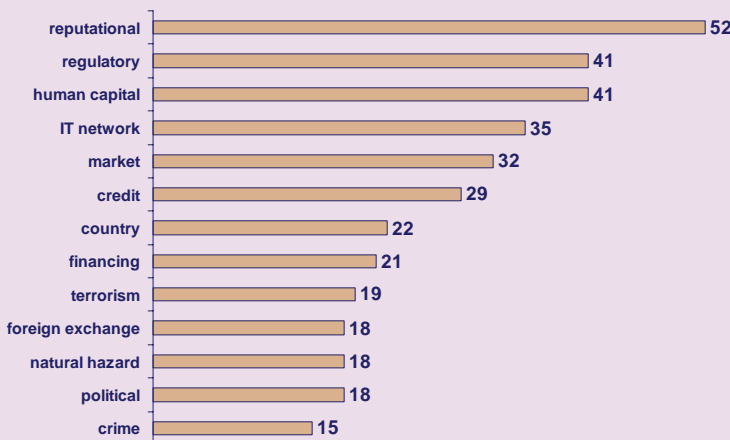
Source: Economist Intelligence Unit and PriceWaterhouseCoopers; "Compliance: A gap at the heart of risk management"; june 2003.

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RELEVANCE OF RISKS



Risk Category	Relevance Score
reputational	52
regulatory	41
human capital	41
IT network	35
market	32
credit	29
country	22
financing	21
terrorism	19
foreign exchange	18
natural hazard	18
political	18
crime	15

Source: Economist Intelligence Unit; "Reputation: Risk of Risks"; december 2005.

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CORPORATE REPUTATION

“Stakeholders form much of their expectations regarding future behaviour and characteristics of a company according to the past ones”

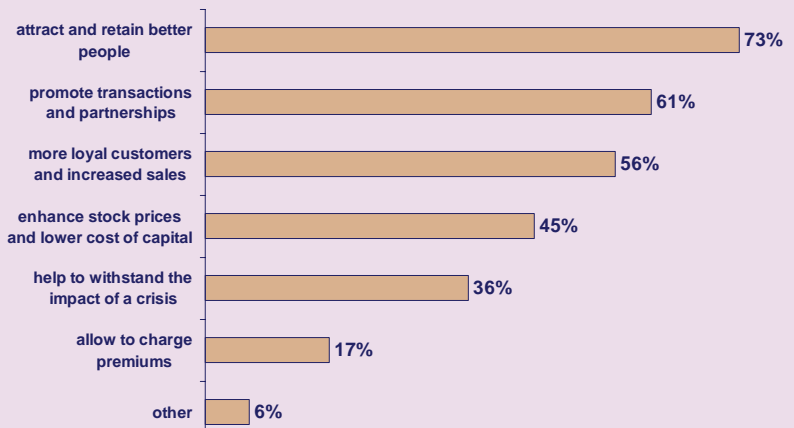
- » It’s achieved over time
- » Can be quickly lost
- » Information asymmetries
- » It’s a competitive advantage

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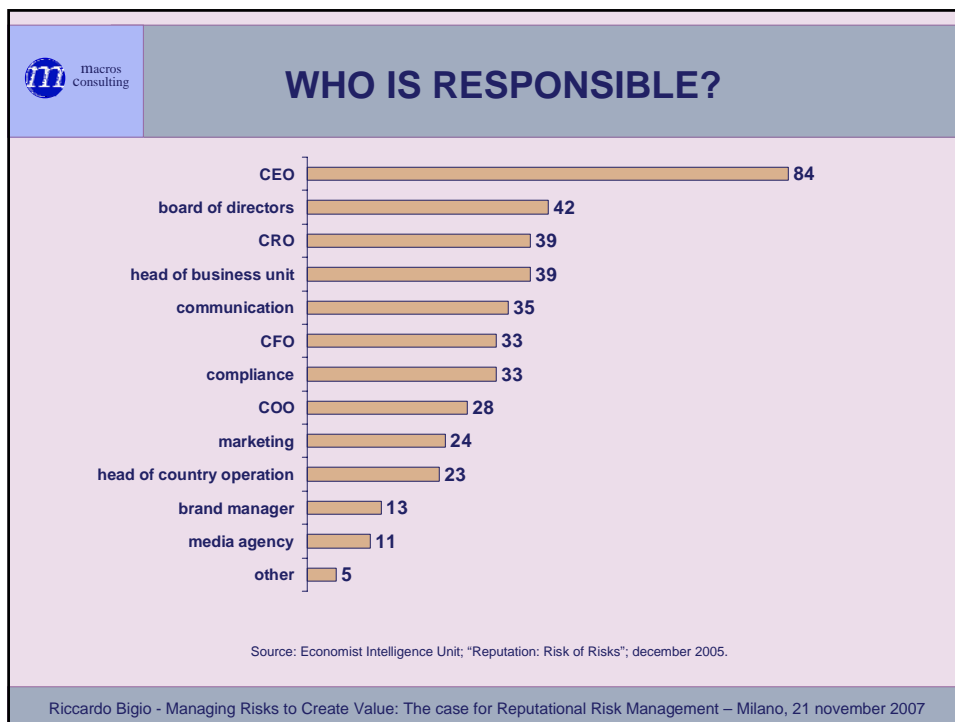
HOW CAN REPUTATION HELP?




Benefit	Percentage
attract and retain better people	73%
promote transactions and partnerships	61%
more loyal customers and increased sales	56%
enhance stock prices and lower cost of capital	45%
help to withstand the impact of a crisis	36%
allow to charge premiums	17%
other	6%

Source: Hill & Knowlton, Inc. and Korn/Ferry International; "2003 Corporate Reputation Watch Survey".

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- Assess reputation
 - Evaluate reality
 - Close gaps
 - Monitoring changing beliefs and expectations
 - Assign responsibilities
- Source: R. G. Eccles; "Reputation and its Risks"; Harvard Business Review; February 2007.
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FRAMEWORK'S REQUIREMENTS

- Consider reputational risk as “add-on”
- Input in the strategic decision making process
- Monitor risk on a daily basis
- Create a KPI dashboard
- Get early-wins to support future developments

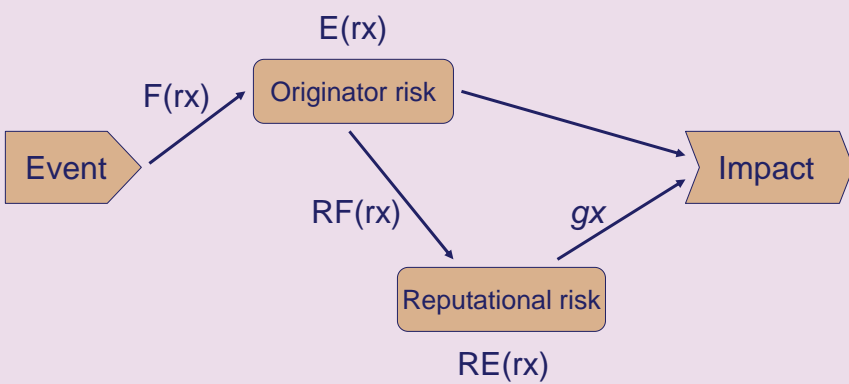
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BASIC ASSUMPTIONS (1/3)

A “second order” risk:




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graph LR
    Event[Event] -- F(rx) --> OR[Originator risk]
    OR -- E(rx) --> Impact[Impact]
    OR -- RF(rx) --> RR[Reputational risk]
    RR -- gx --> Impact
    RR --- RE(rx)
    
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Source: R. Bigio; "A Reputational Risk Management Framework", Etudes et Dossiers n°326, Geneva Association, April 2007".


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THE “FACTORS” BEHIND REPUTATIONAL RISK

- $F(rx)$ = the frequency or likelihood of occurrence of rx ;
- $E(rx)$ = the exposure to rx ;
- $RF(rx)$ = the likelihood that rx can lead to a reputation damage;
- $RE(rx)$ = the exposure of the organization to reputation damage from rx ;
- gx = a factor representative of perceptions gaps

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BASIC ASSUMPTIONS (2/3)

For each “originator risk” rx :

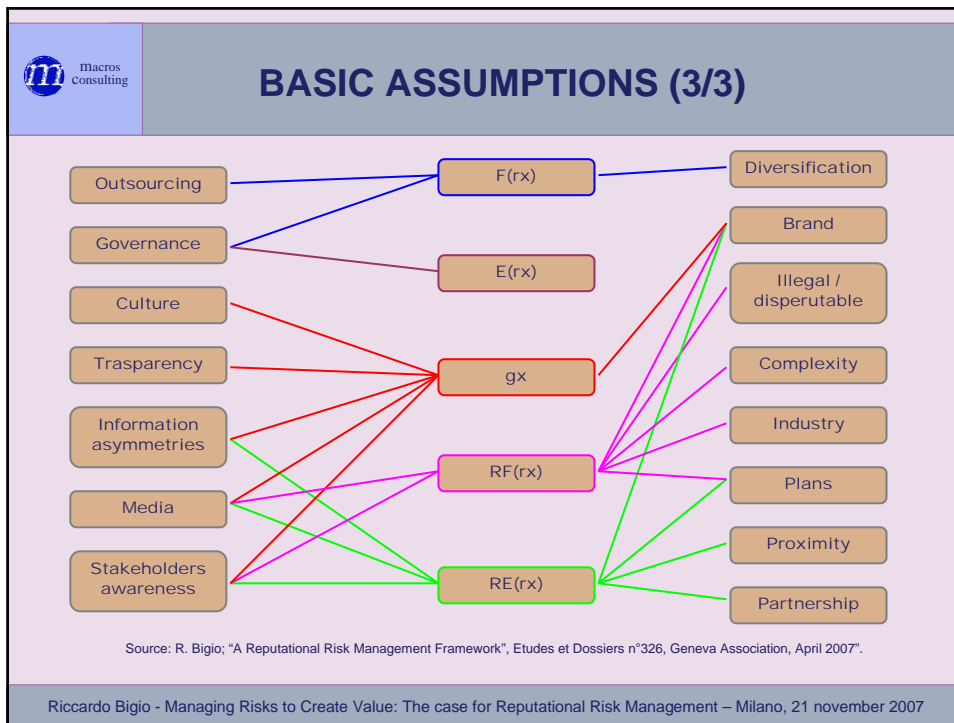
$$I_{rx} = (F_{rx} \times RF_{rx} \times E_{rx})^{gx \times RE_{rx}}$$

Then for n risk factors:

$$I_{ovr} = f(I_{r1}, I_{r2}, \dots, I_{rn}) = f \left[(F_{r1} \times RF_{r1} \times E_{r1})^{g1 \times RE_{r1}}, \dots, (F_{rn} \times RF_{rn} \times E_{rn})^{gn \times RE_{rn}} \right]$$

Source: R. Bigio; “A Reputational Risk Management Framework”, Etudes et Dossiers n°326, Geneva Association, April 2007”.

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- CONCLUSIONS**
- Reputational risks is one of the more relevant
 - Is a competitive advantage
 - Modest resource entailment
 - Many elements are already in place
 - Integration of different risks
 - Input in the strategic decision making process
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