Risk Management and Liability of Multi-national Professional Practices

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The top 10 business risks

Ranking from 2008 in brackets

1. The credit crunch (2)
2. Regulation and compliance (1)
3. Deepening recession (new)
4. Radical greening (9)
5. Non-traditional entrants (16)
6. Cost cutting (8)
7. Managing talent (11)
8. Executing alliances and transactions (new)
9. Business model redundancy (new)
10. Reputation risks (22)

The 2009 Ernst & Young business risk report
The top 10 business risks - the risk radar

The 2009 Ernst & Young business risk report
Do we live in a riskier world?

- The severity of the world's risk profile is increasing
  - the likely impact of "Black Swan" risks is wider and longer-term than businesses have typically had to cope with
  - organisations are inclined to manage the immediate horizon and focus on process, documentation and compliance

- We fear most what we can't easily manage
  - yet large unexpected risks drive history
  - and these are the most challenging to manage

- The winning organisation will have a greater awareness of the environment they operate within
  - adapting to changing situations and evolving as risks evolve
  - evolving as their client's and supplier's risks evolve
  - looking beyond the immediate horizon
Lessons to learn from the recession

- Risk management must be given more authority
- Senior executives must lead risk management from the top
- Institutions need to review the level of risk expertise
- Institutions must pay more attention to risk related data and use data with judgement
- Stress testing and scenario testing is key
- Incentive systems should reward long term stability not short term gain
- Risk factors should be consolidated across all operations
- Don't rely excessively on external data
- Centralisation and decentralisation should be balanced
- Risk management systems must be adaptive not static

The Economist Intelligence Unit 2009
Serious risk deficiencies uncovered

- In good times risk management can be swept aside in the quest for profit
- The balance of power needs to shift
- Armed with authority, visibility and a route to the top risk management should be an integral part of recovery
- Risk tools, techniques and people have not always been fit for purpose
- This is an opportunity for risk managers
  - if they are up to the job
- But if you do put your head above the parapet make sure you know what you are doing…..
- Recent research indicates a deficit in skilled risk managers
Six ways to mismanage risk

Six routine mistakes

▪ relying on historical data
▪ focusing on narrow measures
▪ overlooking knowable risks
▪ overlooking concealed risks
▪ failing to communicate
▪ not managing in real time

In summary to manage risk effectively

▪ choose the right data and metrics
▪ view the whole picture
▪ understand how the parts move
▪ model and test scenarios
It's risk Jim but not as we know it ...
What does Enterprise Risk Management look like?

Leadership
- Risk management effort is proportionate.
- Senior management is truly engaged (more than providing a budget, actually seek risk information for their decision making).

People
- Excellent central technical expertise for risk management.
- Risk management professionals seek continual improvement, collecting ideas internally and externally.
- All personnel (including senior staff) are trained in core risk management skills.

Policy & strategy
- Risk management is carried out organisation-wide.
- Risk management activities are aligned with the organisation’s Mission.

Partnership & resources
- Sufficient effort and resources are given to treating risk (in addition to risk analysis).

Processes
- Use risk management as a thinking process (are not bogged down in the process).
- Risk management is embedded within core processes (so that key decisions can be made with good risk information).
- Greater emphasis on taking opportunities (upside risk).
- Sufficient effort on analysing risk.
- Risk management processes are consistent, such that risk information can be consolidated.

Source: Research into the Benefits of ERM undertaken by DNV for AIRMIC, 2008
Management standards

- Standards can
  - be a way of finding what is regarded as good practice
  - save time as a proven process can be followed
  - define the terminology
  - be used as a benchmark against individual deliverables and help set targets for improvement
  - be used as proof of organisational ability and improvement
  - help internally to set objectives and obtain a budget
  - provide an independent view of good practice
  - help cross-boundary management
Examples of standards include

- Sarbanes-Oxley and COSO
- Cadbury, Turnbull, Higgs and the combined code in the UK
- ISO 14001
- ISO 27001
- ISO 9001
- BS 25999
- BS 31100 / ISO 31000
- Industry Codes and Handbooks
- Lexcel / Law 9000
- Firm standards - DLA Piper Way

Not all appropriate and not all appropriate for law firms

Increasingly a focus for clients and suppliers - yet knowledge in professions about these is patchy (Managing Partner Forum research 2008)
Risk management model - BS 31100
Organisation - professional service practices

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Procedures</th>
<th>Grey Hair</th>
<th>Rocket Science</th>
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<tbody>
<tr>
<td>Common &amp; simple issue</td>
<td>Choosing implementation across complex alternatives</td>
<td>Deciding on a major, ill-defined issue</td>
<td>A complex issue of which client has no experience</td>
</tr>
</tbody>
</table>

Selling Proposition

- Efficiency
- Experience
- Expertise

Organisational capabilities

- Efficient service processes
- Methodologies
- Best practices
- Learning from experience
- Risk management
- Rigorous empirical analysis
- State-of-the-art theory

“drift to the left”

Harvard Business School 2007
The external dimension

- Based on the indicators of appetite, awareness and ownership, research (JR Consulting Partners 2003) has concluded significant regional variations in attitude to risk:
  - Eastern Europe: high awareness, low appetite and ownership of risk
  - Western Europe: above norm appetite and awareness, below norm awareness
  - Southeast Asia: below norm appetite and ownership, above norm awareness
  - North America: Above norm appetite and awareness, below norm ownership
- Attitudes to the past, present and future may affect how organisations build resilience and response
- But whatever the attitude, the freedom to act may be shaped by the political and social environment
Risk managing in an international environment - the cultural factor

The internal dimension

A global strategy may be flawed by local cultural factors at odds with the central approach

- especially critical if out of country services or products form part of the organisation’s supply chain

- If the organisation “off-shores” business capability, cultural differences between the parent and host countries will be key

- Maturity of the organisation may influence culture:
  - dot-com “can do” = high risk/reward attitude
  - banking sector = lower risk/reward attitude

- Risk management cannot be imposed
  - strategy must take account of global and local differences in risk appetite, awareness and ownership
Supply chain risk management

If your suppliers don't deliver you don't deliver

- Which are business critical?
- What level of comfort do you have?
- What due diligence exists?
- What audit/information rights do you have?
- What termination rights exist?
- What contingency arrangements are in place?
- Any key provisions for re-negotiation?

Applies to
- outsourced / off-shored solutions
- property
- insurance
Client risk drivers

- Retreating from risk
  - increase in liability limits
  - increase in punitive conditions

- Greater reliance on standards
  - wider range of standards
  - right to audit

- Flight to quality and value
  - interested in quality with assurance

- Trends in client terms of business
  - sector variations e.g. government and financial services
  - regional variations e.g. Middle East
## Risk sector impact matrix - E & Y report

<table>
<thead>
<tr>
<th>Risks</th>
<th>Asset management</th>
<th>Automotive</th>
<th>Banking</th>
<th>Consumer products</th>
<th>Insurance</th>
<th>Life sciences</th>
<th>Media and entertainment</th>
<th>Real estate</th>
<th>Oil and gas</th>
<th>Telecoms</th>
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Risk in law firms

- Risk Management is increasingly recognised as important and a core business activity
- But the response to risk management varies and reflects:
  - business model
  - size
  - maturity
  - client needs
  - client sectors
  - scope - geographic
  - scope - practice group
  - experience
- In practice, the definition of risk varies significantly
Risk management at DLA Piper

- Integrated business activity
- Enterprise Risk Management approach
- Quantitative and qualitative risk appetites
  - regulatory
  - financial
- Appropriate risk for appropriate return
- Reduce uncertainty or volatility
- Resilience and response
- Independent assurance to the Board
- Part of the Firm's governance framework or system
Risk management at DLA Piper

- Driven from the top
  - Board - senior partner
  - Risk committee - chief operating officer
  - Client committee - strategy director and managing directors

- Independent

- A check and balance
  - entrepreneurial business / "salad bowl" of people and experience

- Well resourced
  - risk knowledge managers

- Risk, geography and service focus

- More than support
The role of the chief risk officer

- Police officer
  - independent
  - knowing when and how to apply the brake
- Teacher
  - educator
  - counsellor
  - advisor and commentator
- Business leader
  - commercial view aligned to business goals
  - risk / reward balance
  - risk leader
- The emphasis of role will vary from one firm to another
  - the approach must fit the scale, nature and complexity of the firm
Risk management system at DLA Piper

- Risks identified at three levels
  - strategic
  - tactical
  - functional
- Risks categorised
  - financial
  - business
  - legal & regulatory
  - operational
- Risks assessed by severity
  - impact: 6 scales
  - probability: 6 scales
Risk management system at DLA Piper

- Risk appetite varies by level
  - % of revenue and % of profit
  - qualitative
  - financial appetite is an insurance driver

- Risk and loss register

- Framework
  - policies
  - processes
  - guidance
  - communication + push and pull
  - education embedded at all career levels + tracking with measures
  - quality and assurance + systematic audit
Risk management responsibilities

- **Corporate**
  - centre of Risk knowledge excellence
  - policy and practice design and oversight
  - systems and process design
  - first line of Group, Sector and other Operations Group contact
  - training, education and communication design and co-ordination

- **Regional Development**
  - policy and practice development and implementation
  - training, education and communication
  - first line of Regional contact as “account managers”
  - quality assurance

- **Central Services**
  - specialist client and matter intake
  - first line of contact for the services provided
  - right work, right place – experience matters
Insurance Application

DLA Piper International LLP Proposal 2008

International LLP has an established Training and Development Team and also has its own Risk Management Training Programme
Communication - risk management brand

[Images of web pages and documents related to risk management and communication strategies.]
Top 10 insurer risks

1. Investment performance (11)
2. Equity markets (13)
3. Capital availability (26)
4. Macro-economic trends (-)
5. Too much regulation (1)
6. Risk management techniques (14)
7. Reinsurance security (27)
8. Complex instruments (19)
9. Actuarial assumptions (8)
10. Long tail liability (7)

(Last survey figures in brackets)
What keeps insurance CEOs awake at night?

- The environment
  - low or negative investment returns
  - an acute shortage of capital
  - dreadful macro-economic outlook
  - backlash against financial complexity
  - increasing political involvement - even in mature markets
  - the inevitability of much tougher regulation (and the cost of this) at all levels

- The effects on non-life and life are different
  - non-life: capacity and pricing are the issues
  - life: investment returns are the major threat

- Pervading fear is that the industry is not as well prepared as it should be
Current AIRMIC initiatives

- Insurance
  - reservation of rights
  - claims good practice
  - speed of settlement
  - benchmarking
  - AIRMIC analytics
- Risk
  - ERM research
  - risk appetite
- Career model
- Value model
- Education
What can firms do about professional indemnity?

- Present the firm well
  - act smart
  - communicate recent developments/headlines
  - explain the firm's profile
  - describe practice details
  - evidence governance
    - global / local
    - governance structure
    - risk management system as part of governance
  - demonstrate training, development and knowledge
  - professional Indemnity claims management and data
  - include a response to typical issues raised by underwriters

- Set minimum carrier and broker standards

- Take the initiative
Recession - build resilience and response

- Continuity of insurers is a supply chain risk

- Actions might include
  - Identify insurers and their affiliates
  - Conduct a risk assessment
  - Understand cover, exposure, terms and conditions
  - Monitor insurer Outlook and Financial ratings
  - Monitor news
  - Plan for the worst case scenario
    - Triggers
    - Transfer options
    - Tail covers
    - Risk is not confined to premium - look at claims too

- Have a plan - it's too late to plan once things go wrong
What can insurers and brokers do for firms?

- **Insurers**
  - partners and not fair weather friends
  - define and reward good risk management practice
  - view risk as an opportunity creator not just to be eliminated
  - adopt good practice

- **Brokers**
  - partners
  - evidence value
  - deliver service level agreements

- **Panel**
  - increasingly analysed as suppliers