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EVERYTHING MATTERS

Risk Management and Liability of Multi-national Professional Practices

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The top 10 business risks

Ranking from 2008 in brackets

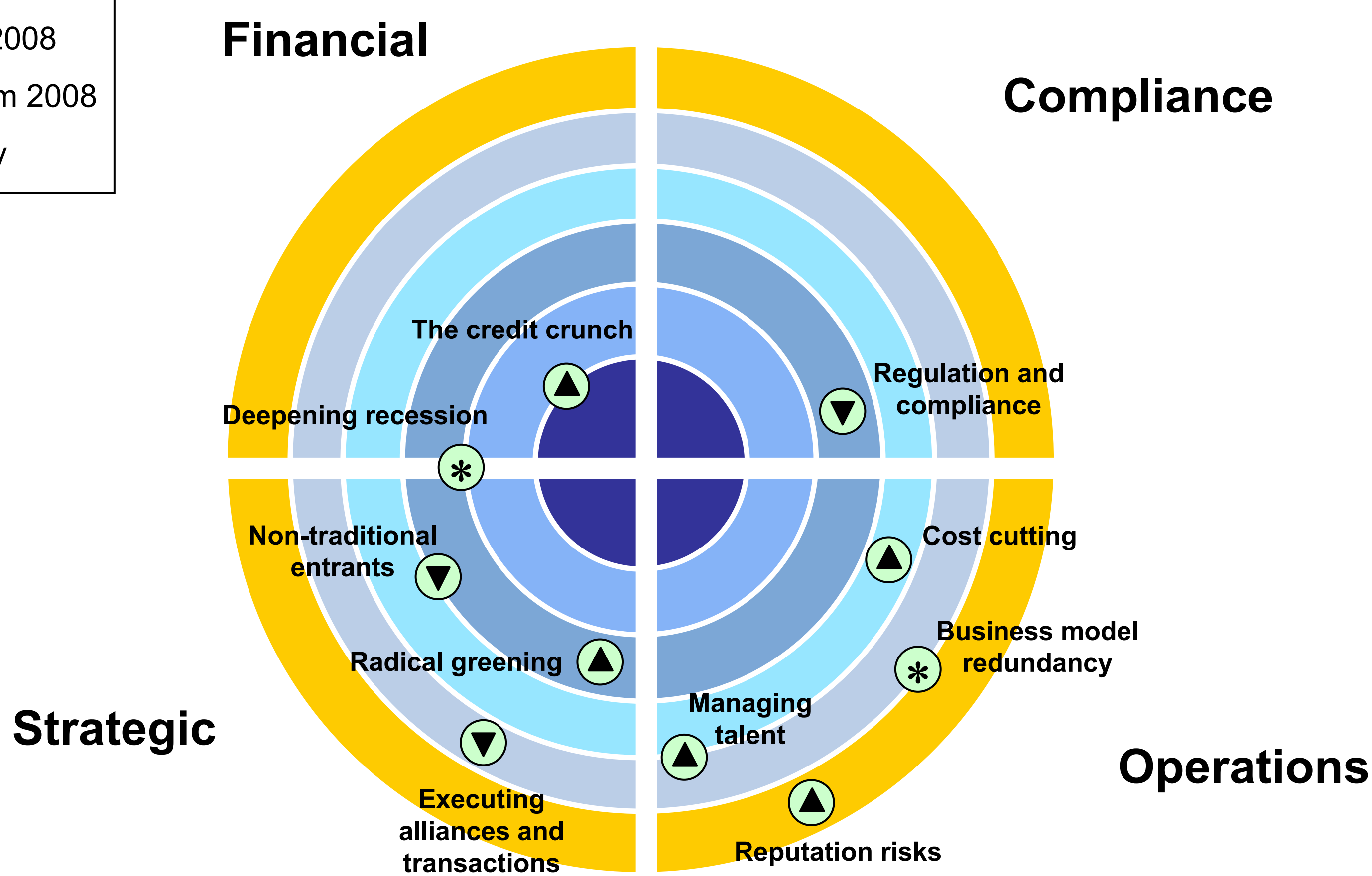
1. The credit crunch (2)
2. Regulation and compliance (1)
3. Deepening recession (new)
4. Radical greening (9)
5. Non-traditional entrants (16)
6. Cost cutting (8)
7. Managing talent (11)
8. Executing alliances and transactions (new)
9. Business model redundancy (new)
10. Reputation risks (22)

The 2009 Ernst & Young business risk report

The top 10 business risks - the risk radar

Key to symbols

- ▲ Up from 2008
- ▼ Down from 2008
- ✱ New entry



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**

Harvard Business Review March 2009

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

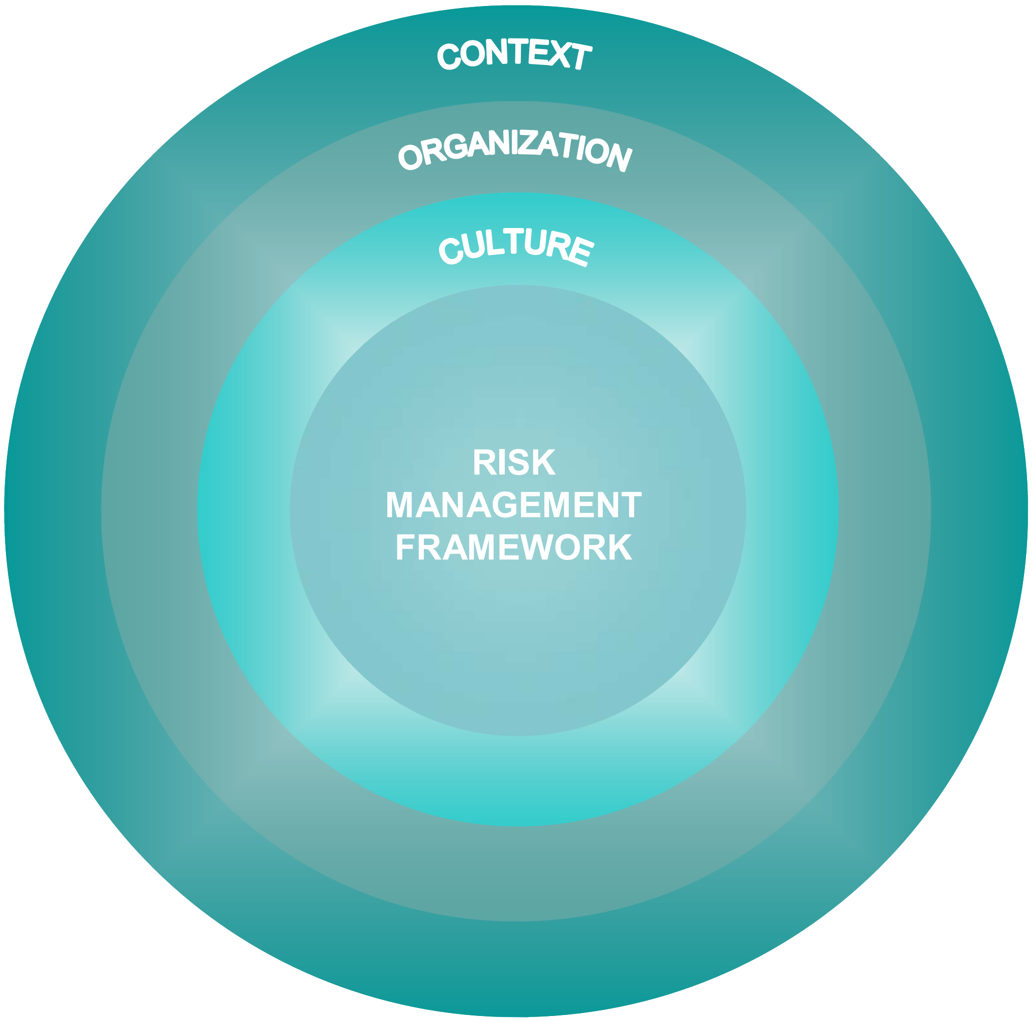
Management standards

- 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

- 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

	Commodity	Procedures	Grey Hair	Rocket Science
Client Problem	Common & simple issue	Choosing implementation across complex alternatives	Deciding on a major, ill-defined issue	A complex issue of which client has no experience
Selling Proposition	Efficiency	Experience		Expertise
Organisational capabilities	Efficient service processes	Methodologies Best practices **Risk management**	Learning from experience 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

Industries

Impact scale

- Critical
- High
- Medium
- Moderate

Risks	Asset management	Automotive	Banking	Consumer products	Insurance	Life sciences	Media and entertainment	Real estate	Oil and gas	Telecoms	Utilities
1. The credit crunch	Critical	Critical	Critical	Medium	Critical	High	Critical	Critical	Moderate	Moderate	Critical
2. Regulation and compliance	Critical	Medium	Critical	Medium	High	Critical	Medium	Medium	Critical	Critical	Critical
3. Deepening recession	Critical	Critical	High	Critical	High	Moderate	Critical	Critical	High	Moderate	Moderate
4. Radical greening	Medium	Critical	Moderate	Critical	Critical	Moderate	Medium	High	High	Medium	High
5. Non-traditional entrants	High	Medium	Medium	High	Moderate	Moderate	Critical	Moderate	Critical	Critical	Moderate
6. Cost cutting	Moderate	Critical	Moderate	Critical	Moderate	Moderate	High	Medium	Critical	Medium	High
7. Managing talent	Medium	High	High	Medium	Moderate	Moderate	Medium	Critical	High	High	Moderate
8. Executing alliances and transactions	Medium	Moderate	Medium	High	Moderate	Moderate	High	Moderate	Moderate	High	High
9. Business model redundancy	Critical	Moderate	Moderate	Moderate	Moderate	High	High	Moderate	Moderate	Critical	Moderate
10. Reputation risks	Critical	Moderate	Critical	Moderate	Moderate	Medium	Moderate	Medium	Moderate	Moderate	Medium

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

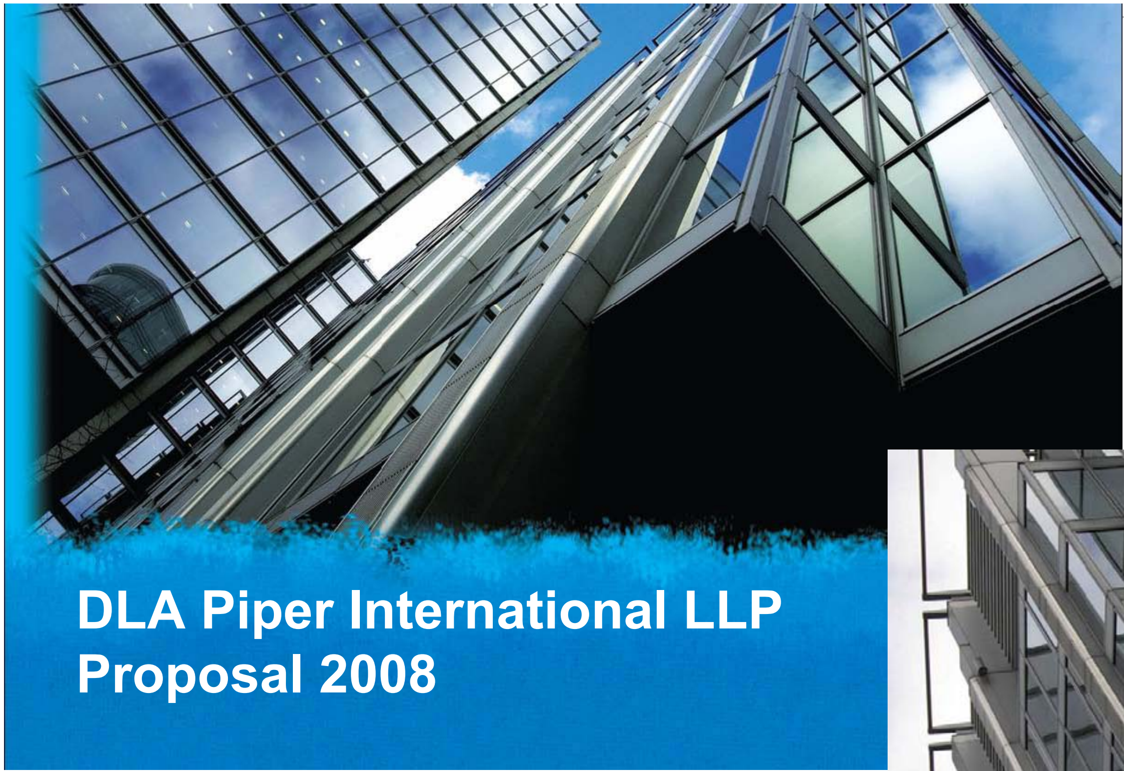
Risk management system at DLA Piper

- 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



Communication - risk management brand

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)

Insurance Banana Skins 2009 CSFI

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 ADVISEN FPN FRONT PAGE 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