LLOYD'S

360

DRIVING THE DEBATE ON EMERGING RISK

GLOBAL BUSINESS UNDER ATTACK?

From climate change to terrorism and liability, global business is under threat like never before. In this feature Lloyd's tackles the issues head on, driving the debate on emerging risk.

IS TERRORISM A REAL THREAT?

Home-grown terrorism presents business with a new challenge of a different magnitude

Terrorism has long been a feature of the landscape in Britain, but the onset of Islamist extremist terrorism presents a new risk, one which UK Prime Minister Gordon Brown has described as a "generational challenge". However, there is a surprising paradox at the heart of our response to this challenge. While Lloyd's research carried out last year, reveals that more than 90% of business leaders are concerned about home-grown terrorism - and almost a quarter think it presents the highest security risk to their business over the next five years - the majority admit that they do not understand the nature of the threat, let alone its potential impact on their business. This gap in understanding needs to be filled urgently, so business leaders can assess what steps are practical in protecting their organisations and their staff.

Setting the context: Terrorism trends

So what are the facts? Counter-intuitively, many experts suggest that other than in Iraq and Afghanistan, global incidences of terrorism and political violence have reduced in the last couple of years.

However, 59% of global business leaders think that terrorism and political violence will increase over the next five years. This could be because the number of 'fragile states' has increased, according to Department of International Development and World Bank classifications. In any event, it is clear that the global business community perceives and accepts that there is a threat.

> "The majority of global CEOs believe that business is now as much at risk from terrorism as government."

In the UK, the Home Office believes that around 200 groups pose a specific threat and MI5 has identified 2000 individuals known to be a direct threat to British national security. In a speech to the Society of Editors in November last year, Jonathan Evans, MI5's Director General, stated: "I do not think that this problem has yet reached its peak."

Global CEOs believe that violent groups with religious motivations present the greatest terrorist threat to business, no doubt driven by the preference of jihadi terrorists for attacks which result in mass casualties and maximum disruption. One of the factors which makes jihadi terrorists so menacing is their use of innovative techniques, and the phenomenon of suicide attacks in order to achieve martyrdom. This is a troubling psychology, which is hard to understand and more difficult to counter.

Understanding the risks for business

The attacks on the World Trade Centre in 2001 account for one quarter of all fatalities in attacks on business in the last 40 years. Over this period, most attacks on businesses have actually come from left-wing or issue-based groups. In reality, an increased threat from religious extremism does not automatically lead to a greater threat for business.

However, the majority of global CEOs believe that business is now as much at risk from terrorism as government. Al-Qaeda and its emulators have specifically focused on key economic targets over the last decade. The alleged plot to blow up the International Monetary Fund and World Bank buildings in Washington, the New York Stock Exchange and Citigroup buildings in New York, and the Prudential building in Newark, New Jersey, all support this view.

Sixty-three percent of executives therefore perceive that their companies face violence more because of association than what they do themselves. Targets, including those of an economic nature, are chosen for their potential to have the biggest and most negative impact on government and society. Terrorists also attempt to make political statements through their violence. In Spain, one of the outcomes of the Madrid attacks was the withdrawal of troops from Iraq. The impact of the terrorists' psychology is difficult to gauge, but it seems highly likely that they will continue to target economic interests at home and abroad as they pursue their aims.

How can business manage the home-grown terrorism threat?

Sixty-five percent of business leaders surveyed by Lloyd's rely on international media to get their information on terrorism and political violence risk, but this is not always accurate and up-to-date, or indeed specific enough for individual business or local use. Faced with an increasingly complex geopolitical environment, the most forward-looking organisations are taking greater steps to analyse and understand the risks they face. A wide range of expertise is available from national and international government departments and agencies (visit www.lloyds.com/terrorismlinks for more information). In the UK, through the Centre for the Protection of National Infrastructure run by MI5, the Government provides protective security advice to businesses and organisations. There are many other independent sources, often providing guidance to the business community. Advice from non-governmental organisations and academic reports is often of a very high quality and is usually available for no charge. Critically, there has also been a rapid expansion in the range and quality of private consultancy advice available.

Lloyd's own work suggests that risk management thinking among the most risk-aware companies is beginning to converge in a number of areas. As most business leaders already know, ensuring that the risk of home-grown terrorism is built into business continuity planning is critical. However, plans need to be both comprehensive and flexible, in order to be able to respond to the evolving threat. Twenty percent of firms now specifically address the risk of a chemical, biological or nuclear attack in their plans, a sensible step given the foiled ricin poisoning plots in England in 2005.

A company that effectively manages home-grown terrorism must also have a detailed understanding of its supply chain and chokepoints, and how an attack which affects some part of the chain - whether directly or indirectly - will impact on the business overall.

> "Security cannot be the responsibility of Government alone; the burden for security has to be shared between the Government and the people in private sectors."
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> **- PETER HO, CIVIL SERVICE/ PERMANENT SECRETARY (SPECIAL DUTIES) (PRIME MINISTER'S OFFICE)/ PERMANENT SECRETARY (FOREIGN AFFAIRS/ PERMANENT SECRETARY) (NATIONAL SECURITY AND INTELLIGENCE COORDINATION), SINGAPORE GOVERNMENT**

In a globalised world, senior managers need to develop contingency plans in co-operation with other parties in their chain.

Forty-one percent of companies have also invested in increased IT security because of cyber-terrorism - a risk which is growing in prominence, and may feature in future terrorist attacks as computer-literate recruits rise through the ranks, and as the distinction between terrorism and organised crime blurs.

Above all, the most forward-looking companies demonstrate a different mindset, where security and risk management is adopted as part of corporate culture and seen as an enabler rather than a hindrance. Increasingly, security features should be built into the design of new buildings, with the creation of safe rooms moving from the realm of Hollywood movies into the business of saving lives. Furthermore, businesses should monitor who their neighbours are, as the majority are most likely to suffer damage as a the result of getting caught up in terrorist attacks indirectly.

> "What is required is not that businesses interfere in political issues but that they help to foster carefully focused economic activity, promote diversity in the workplace and engage in local community projects at home and abroad."

The wider role of business in the fight against extremism

In the UK, MI5's analysis highlights the need to address the root causes of home-grown terrorism - something which the intelligence services and police cannot do alone. As Jonathan Evans says, the fight against terrorism will be a collective effort in which wider civil society will be a crucial player.

Just as the Government invests in the "hard-edged" security infrastructure to physically prevent terrorist attacks and plans to ensure that the economy and civic life are resilient in the face of successful attacks, it also invests in the "soft-edged" but important work of engaging with the Muslim community in a way which isolates extremists and boosts a sense of community strength and inter-faith dialogue.

The approach that business takes should in many ways mirror this strategy. Despite the traditional belief among executives that it is best to take a low-profile and defensive position in times of instability, many experts now believe that the business community can and should play a more active role in countering the conditions which breed home-grown terrorism. What is required is not that businesses interfere in political issues but that they help to foster carefully focused economic activity, promote diversity in the workplace and engage in local community projects at home and abroad.

Ultimately, no amount of proactive measures can completely shield a business from terrorism, and businesses face a continuing struggle. But, even in this changing world, business is not powerless and a carefully thought-out risk management strategy, which tackles not only immediate physical security issues but contributes to wider and longer-term social and economic issues, can make a real difference.

One of the key themes of Lloyd's 360 risk project is terrorism and political risk. For more information or to read our report 'Home-grown Terrorism : What does it mean for business', visit www.lloyds.com/360

TERRORISM RISK IN SOUTHEAST ASIA

Nigel Inkster, Director of Transnational Threats and Political Risks at the International Institute of Strategic Studies (IISS). Author of a new report commissioned by Lloyd's

Fascination with emerging economies such as China and India may dominate the development strategies of most global businesses right now, but Southeast Asia continues to achieve the highest rates of foreign direct investment in the region as a proportion of GDP - at 40% far outstripping South Asia (7%) and China (11%). While key challenges remain in certain areas of the continent such as corruption, political and civil instability and poor infrastructure, Southeast Asia is by contrast seen as a relatively stable and benign environment for foreign investment.

Opportunities remain considerable but one factor which needs to be borne in mind by companies seeking to do business in the region is the issue of Islamist jihadist terrorism. Taken together with local terrorist campaigns and violent crime, this makes for a complex risk environment where local knowledge, effective security practices, good staff relations and a strong programme of community outreach can help reduce - though never eliminate - risk.

Six years after the 2002 Bali bombings, a combination of local and international action has led to a substantial reduction in the threat from Islamist jihadist terrorism in the region. But the threat has not been entirely eliminated as evidenced by the recent arrest in the Philippines of a group of Middle Eastern nationals allegedly planning to bomb a number of Western embassies in Manila. In particular, businesses need to bear in mind that preferred targets of Al-Qaeda influenced groups typically include iconic buildings symbolising Western capitalism, mass transit systems and entertainment centres including luxury hotels. Even if companies themselves are not the target of a terrorist attack, mere proximity to such a target can create almost as much disruption as a direct hit. Furthermore, some landmark British businesses might become targets precisely because of their national provenance, especially at moments when the UK's foreign policy is seen as controversial in the Islamic world.

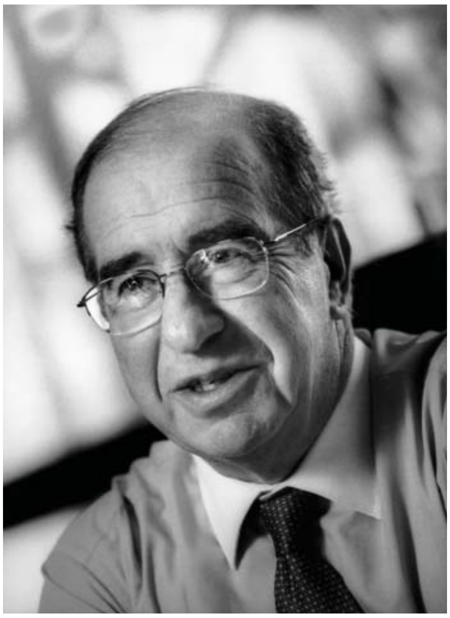
Ultimately, however, Islamist jihadist terrorism is not the main current threat in the region: localised insurgencies (driven largely by separatist agendas but with religion sometimes a contributory factor) plague parts of Southern Thailand, Mindanao in the Philippines, and the Sulawesi and West Papua regions of Indonesia. While largely unreported in the Western press, these insurgencies undermine the effectiveness of local administrations and pose particular risks for would-be investors. In Southern Thailand for example, there have been in excess of 2,400 deaths through violence in past three years, and a recent car bombing in Pattani targeted a hotel popular with visiting foreigners. A particular concern in these more remote areas is the risk of kidnapping with Westerners as possible targets. For example, the Abu Sayyaf Group in the Philippines has a track record of kidnapping Westerners, most recently an Italian missionary. In contrast, it is difficult to get any hard data on the kidnapping of indigenous residents, due to the fact that these often go unreported. But kidnapping and extortion appear to be the main ways in which groups such as Abu Sayyaf raise revenue.

The message for businesses planning to invest in this part of the world is therefore similar to anywhere else, but it needs to start with a proper risk assessment drawing on expert local knowledge from the private sector, and supplemented by the information available from the Foreign and Commonwealth Office's Security Information for Businesses Overseas (SISBO), think tanks and other research institutions. Once established, there should be no need to adopt unduly elaborate security precautions over and above those needed by any business operating in today's world. The key lesson is to treat good security as a business enabler and embed it as an integral part of corporate culture.

View a copy of the full Lloyd's and IISS report 'Terrorism in Asia: What does it mean for business?' visit www.lloyds.com/360

FCO, COUNTRY PROFILES FOR SINGAPORE (18 JANUARY 2008) & MALAYSIA (SEPTEMBER 2007).

> "The key lesson is to treat good security as a business enabler and embed it as an integral part of corporate culture."



VIEWPOINT: “BUSINESS CANNOT BE SUCCESSFUL WITHOUT TAKING RISKS”

Lord Levene, Lloyd’s Chairman

“If you say hurricanes are a higher risk than terrorism, that’s fine until something comes along that you didn’t see,” says Lord Levene. “You cannot really rank risks. You have to look at them in parallel.”

The Lloyd’s Chairman does know where to look when it comes to emerging risks, however. One obvious contender is climate change, though the debate about whether it’s increasing the incidence of natural catastrophes is still raging.

“The jury’s out on that,” he says. “But there’s no doubt climate change is happening and at a time when an increasing proportion of the global population is moving to coastal areas.”

Another emerging danger is terrorism and political risk, which is similarly difficult to quantify.

“Was Pakistan one of the places where people would expect increasing upheaval? Absolutely,” says Levene.

“Was Kenya? Absolutely not. You have to be very wary about this. Political risk has become a lot more complicated. The world is fundamentally a riskier place than it was 20 years ago.”

A third emerging risk is that America’s litigation and compensation culture will become ingrained in the UK. Levene says that although we have contained things thus far, the future is less certain. Then there’s the internet, which he believes poses a “very, very serious security problem”.

The risk of contagion in world financial markets is clearer than ever and, as Lord Levene points out, “It’s not a potential risk; it has happened.” Despite this, he reminds us that, “We should not forget that we have just been through a period of huge economic growth and prosperity.

“If you don’t have risk in the system, you also don’t get the rewards. We’re now paying the price for some of the risks that have been taken, but if no systemic risks had been taken five years ago, the system would have stagnated”.

As Levene points out, a primary role of the insurance industry is to help manage uncertainty. “At Lloyd’s we are all about risk. If we eliminate that, we will eliminate our business. The whole point of Lloyd’s is that we are there to facilitate the transfer of risk”.

However, Levene believes the world views risk as part and parcel of doing business. And clearly, he wants Lloyd’s to continue helping companies mitigate their changing risks.

“There’s absolutely nothing that we can do to stop risks occurring. Insurance in itself cannot get rid of risk events but it can mitigate against risks.”

> “The world is fundamentally a riskier place than it was 20 years ago.”

Business can learn from the past too, he says, and the most important response should be to carry out full risk surveys at least twice a year. “We do it ourselves at Lloyd’s and we always find something on which we have to act. As an insurance business, it is especially important that we have the right strategy and process in place to manage our own risk”.

DIRECTORS IN THE DOCK?

Understanding the latest corporate liability trends, by Andrew Cave

Andrew Cave has written about business and the City for 17 years. He now works as a freelance journalist for the Daily Telegraph as well as other specialist publications.

Eight years after the start of the dotcom crash, another major reverberation of world financial markets is reminding businesses just how great their liability exposures could be.

Until now, the liability issue for insurers arising from the global credit crisis has been, as Hiscox Chief Executive Bronek Masojada says, "the dog that didn't bark", with relatively few liability claims resulting on this side of the Atlantic. However, the crisis could yet lead to individual company directors becoming targets for professional liability claims, perhaps exceeding those seen after the dotcom crash.

All this may be viewed in the context of growing concern that a US-style compensation culture is spreading to Europe and the UK. In these regions, boards report that they are allocating increasing resources to litigation, with an accompanying impact on costs. Companies as diverse as food manufacturers and mineral miners are testifying that liability risks are not confined to financial services businesses. Security of information is a growing worry to government as well as business - something evidenced by the recent furore over lost NHS records and tax and pensions data in the UK. Environmental risks, including climate change, are increasingly seen as potential causes of claims. Faced with these trends, are boards doing enough to discuss their liability risks and to embed risk management processes to cope?

> " Businesses do not spend enough time on discussing their liability risks. "
>
> **BRONEK MASOJADA, HISCOX**

Evidence from the 2008 Lloyd's Annual Underwriter Survey suggests that more action needs to be taken. More than half of respondents said they believe that the compensation culture is now out of control. Sixty-two percent of the underwriters surveyed believe that executives need to do more to prepare for the impact of liability risk on their business, even though insurance buyers are giving the subject greater consideration than they did a few years ago.

Rick Haythornthwaite, the chairman of Mastercard says: "There is no doubt that boards have to think sensibly about liability and understand completely what the duties of directors are." Looking ahead, the task for companies is to ensure that the structures are in place to consider and evaluate visible potential liability risks.

Masojada at Hiscox says: "Enterprise risk management needs to really develop to deal with the concept of broader enterprise risk." One major FTSE100 company, he says, regularly ranks its top ten liability risks and checks to see if its level of protection matches the perceived risk. "I would say that is exceptional, however," he adds. "Businesses do not spend enough time on discussing their liability risks."

Worryingly, there is evidence that many companies do not conduct employee training on how to manage liability risk, and have not adopted formal policies to manage litigation risk. There is also a tendency to give most attention to risks that have been the subject of regulatory activity. In contrast, far less attention had been paid to other emerging liability risks, such as work-related stress and environmental damage.

At Center Parcs, the UK holiday and leisure parks business owned by private equity group Blackstone, Chief Executive Martin Dalby feels that boards should give more time to liability issues. "As a UK business with responsibility for more than five million guests every year on our premises and 6,200 employees, we have always had a fairly significant agenda around risk, health, safety and all of those associated matters. But I would also add that probably most of it is dealt with below the board level because the board never seems to have the time to give it full attention."

Business leaders must develop better strategies for dealing with the legislative changes that have occurred recently. Understandably, businesses will continue to complain about over-regulation, but some aspects of legislation, such as the Corporate Manslaughter and Corporate Homicide Act in the UK, have changed the nature of how the individual can seek redress from companies in the event of a fatality.

Stephen Catlin, Chief Executive of insurer the Catlin Group, concludes: "There is a lot of pressure on companies from regulators to understand the risks they are taking but it takes an event to change the marketplace. The question is: Is the global credit crisis the event?"

Later this month, Lloyd's and the Economist Intelligence Unit will launch a new report which explores the liability impact of current financial market uncertainty and asks which future liability crises business needs to prepare for. "The early indications are that technology security, environmental liability and corporate governance issues are top of CEOs' future worries," says Sean McGovern, Director & General Counsel at Lloyd's. The report publication will be followed by a half-day conference at Lloyd's on the morning of 20 May, chaired by Clive Anderson, to debate the key issues.

To receive a copy of Lloyd's liability report after publication or for further information on the Lloyd's conference, please email 360@lloyds.com.

CLIMATE CRISIS?

Why taking action makes good economic sense

Climate change may have been temporarily knocked off top spot on the news agenda by the credit crisis, but there is no doubt that it is an issue here to stay. Within the business community, UK brands such as Marks & Spencer are responding to growing consumer pressure on issues like the use of plastic bags, while most senior executives have moved beyond paying lip service to climate change and believe they have a responsibility to influence the external agenda. But with 90% of CEOs in a recent report by Lloyd's, reporting that their shareholders are still indifferent to the debate, is their energy misplaced?

The economic debate has certainly moved on significantly in the last few years. Reports such as The Stern Review on the Economics of Climate Change have all but neutralised the arguments of the climate change sceptics, and business is clearly becoming more convinced that action on climate change makes economic sense. In addition, business leaders are beginning to get a feel for the opportunities which the low-carbon agenda means for industry. Some are already starting to emerge in Britain, including the construction sector as it responds to the Government's target of all new homes being "zero carbon" by 2016, and the entire energy sector as it adapts to the changes under the Planning Bill, Climate Change Bill and Energy Bill, currently passing through Parliament.

It therefore seems surprising that shareholders are indifferent, especially when delegates at a recent Lloyd's conference were clear about the reputational impact of changing behaviour at company level. Almost nine in ten said that businesses which take action on climate change have a competitive advantage over their peers.

The insurance industry's agenda on climate change is pretty clear. We don't just live with and prepare for risk - we have to pick up the pieces afterwards and at Lloyd's we feel the impact of extreme weather more than most. In 2005, the Lloyd's market incurred claims of nearly $7bn following the devastation caused by Hurricanes Katrina, Rita and Wilma - mostly from businesses in the affected areas. We therefore believe that risk management alone is important enough to demand action on climate change, and are encouraged that more than 90% of business leaders surveyed at a Lloyd's event, agreed that climate-friendly behaviour makes good risk management sense.

> "Businesses which take action on climate change have a competitive advantage over their peers."

Part of the immediate problem for many companies is undoubtedly that climate change is still a somewhat intangible and long-term issue, while shareholders need to be satisfied in the short-term. The future financial impact on a company's operations from losses due to climate change is not yet clear, and even amongst respected scientists views may differ as to the effectiveness of various mitigation strategies. Faced with this paradigm of short-term action in view of long-term threat, it can therefore be difficult to secure support for practical initiatives like investment in energy efficiency, which may take many years to break even.

Undertaking research into understanding the future impact of climate change for business and other policyholders is therefore a key theme running through the ClimateWise principles, a new insurance industry initiative developed by a group of UK and global insurers and brokers, including Lloyd's. Increasing awareness of climate change among insurance buyers, and a greater contribution to public policy making are two other key objectives of the programme. We expect this will result in a closer engagement between the insurance sector and business in the future, and a more productive and dynamic relationship between business and government on climate change generally.

In future, as carbon starts to show up on balance books and consumer momentum grows, higher standards and greater transparency on environmental issues will become a point of differentiation for companies. In the end, it seems certain that shareholders will become more vocal in demanding responsible behaviour from their boards, while we will also see growing pressure for companies to report and disclose their climate policy and tactics.

British companies who do not build thinking about climate change into their business model now may therefore find themselves lagging behind the pack of innovators later, unable to catch up.
Of course, this applies to insurers too. As Lloyd's CEO Richard Ward explains, there is much that the sector can gain from a

CLIMATE CRISIS?

continued...

partnership with science and technology, and "an open and ongoing dialogue with the scientific community is crucial to the long-term health of the financial services industry - helping to match the innovation drives of India and China". For its part, Lloyd's is working to ensure that the insurance industry is well placed not only to help society mitigate and manage climate risk, but also enable business to take on new risks as it innovates to meet the challenge. We are already helping to lead the way in providing a major share of the world's insurance of new technology to fight climate change - including around a third of insurance for waste to energy plants, and a quarter of the world's wind farms.

Ultimately, society and the business community will play their part in the mitigation of climate change. We have no choice. Speaking at Lloyd's climate change conference Professor Bill McGuire, Benfield Professor of Geophysical Hazards at University College London, leaves us in no doubt on this, explaining: "my personal view is that in the decades ahead, climate change will come to dominate everything in our lives."

The current challenge for boards is therefore to identify the opportunities which adaptation and new technology present for their company, while taking steps now to ensure that the future impact of climate change does not disrupt business in the way that some fear.

For more research and views on the subject of climate change, visitwww.lloyds.com/climatechange

To share your views on Lloyd's 360 risk project, email 360@lloyds.com