Reputation Risk
Challenges for the insurance market
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Emerging risks workshop
AIRMIC conference - 12 June 2012
1. What is reputation risk?
   - can it be measured, managed & reported?
   - should it be on the risk register?

2. Can reputation risk be insured?
   - challenges for the risk industry
   - opinions of risk managers, insurers, brokers & consultants
distinguishing features

• Reputation is a *business continuity* risk

• It is a *strategic* not operational risk

• It is a *behavioural* risk

• It is an *intangible* risk

• It is a *consequential* risk
risk assessment

• Measure – impossible as it is a consequential risk

• Manage – possible but it is a shared responsibility

• Report – possible if vulnerability is fully appreciated
Reputation is a perception of character and the basis for trust.
stakeholder map – example

Regulators
ISI, Ofsted, Charity Commission

Investors
donors, alumni governors/ trustees

Suppliers
food, services materials

Employees
teachers FT & PT support & maintenance

Local community
neighbours, councils, general public

Customers
parents, pupils - current & future

Academia
prep schools, universities, competitors

Media
national, local & social plus specialist press

Suppliers food, services materials

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expectation alignment

Current Performance | Nature of risk | Action needed
--- | --- | ---
Exceeding expectation | Risk as opportunity | align to exploit
Slightly above expectation | Risk as opportunity | align to exploit
Meeting expectations | No risk | in alignment
Slightly below expectations | Risk as threat | align to improve
Falling below expectation | Risk as threat | align to improve

Exploit | Improve
reputation risk

The potential for loss of value resulting from any ‘reputation damaging’ incident……..

- loss of confidence in management,
- poor investment return for shareholders,
- and generally an erosion of trust.

Note: Damage differs across public, private and professional sectors
<table>
<thead>
<tr>
<th>Level</th>
<th>Stakeholder reaction</th>
<th>Trust damage</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Outrage</td>
<td>Trust completely lost – not recoverable</td>
<td>Fraud, embezzlement, illegal or criminal activity</td>
</tr>
<tr>
<td>4</td>
<td>Disgust</td>
<td>Trust severely damaged – never fully recoverable</td>
<td>Incompetence, poor management decision making</td>
</tr>
<tr>
<td>3</td>
<td>Concern</td>
<td>Trust diminished – recoverable at considerable cost</td>
<td>Accident or safety issue eg product recall</td>
</tr>
<tr>
<td>2</td>
<td>Surprise</td>
<td>Trust dented – recoverable with time &amp; good PR</td>
<td>Poor judgement/lack of control eg supply chain problems</td>
</tr>
<tr>
<td>1</td>
<td>Disappointment</td>
<td>Trust questioned – but recoverable speedily</td>
<td>Inconsistent behaviour eg gap between policy and reality</td>
</tr>
</tbody>
</table>

Shock factor – positive correlation: greater the surprise the greater the damage
## Trust Recovery

<table>
<thead>
<tr>
<th>Key Factors</th>
<th>Aspects</th>
<th>Qualification</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Existing Goodwill</strong>&lt;br&gt;Prior state of trust</td>
<td>- Quantity &amp; Quality&lt;br&gt;- Dependent conditions</td>
<td>Goodwill in the bank – ‘forgiveness factor’</td>
</tr>
<tr>
<td><strong>2. Nature of Threat</strong>&lt;br&gt;Impact event or crisis itself</td>
<td>- Cause &amp; Culpability&lt;br&gt;- Contain-ability</td>
<td>Whose fault? Blame and culpability for the event</td>
</tr>
<tr>
<td><strong>3. Response to Threat</strong>&lt;br&gt;Reaction &amp; crisis handling</td>
<td>- Efficient, Sensitive&lt;br&gt;- Contrition or apology</td>
<td>Immediate response&lt;br&gt;eg product recall</td>
</tr>
</tbody>
</table>

Full recovery – some reputations never fully recover from damaged trust
Risk Officer questions

• How much trust would be lost & with whom specifically?
• How much would this cost our business?
• How quickly can we recover the damaged trust?
• How do we know if the damage is temporary or permanent?
• How do I report this on the risk register or probability-severity matrix?
• Could we insure against a loss of value for the trust ‘outage’ period?
4. Can the risk be insured?
cost of damage

Revenue outage – consequential loss
Opportunity cost – resource diversion

Crisis management – PR agency costs
Goodwill restoration – recovery of trust

LOSS

Impact event  Full recovery

£ value

Time

nadir
Key questions

**Capacity** – Has the market got enough for large claims?

**Hazard** – Why would you insure someone else’s behaviour?

**Information** – How do you carry out effective risk assessment?

**Risk** – Does a claims trigger have to be linked with a defined peril?

**Outage** – How do you link reputation damage to claimed loss?

**Notice** – How do you prove exclusive & extensive cause of loss?
Capacity

- Risk not attractive to insurers - fear of massive liability
- Uncertain amount of cover required & policy wording
- Uncertain limitation of claims & policy exclusions
- Contagion risk within sectors & liabilities beyond insured party
- Necessary to create portfolio to avoid ‘selection against’
- Reinsurance essential to limit insurers liability
Hazard

- Moral Hazard is intrinsic to behavioural risk
- Insured party can influence claim value (deliberate)
- Insured party can increase damage (accidental)
- ‘Public interest’ & ‘selection against’ are insurer hazards
- Difficult to establish claims triggers or value at risk
- Many stakeholders provide conflicts of interest
Information

- Information required by insurer is considerable
- Vulnerability assessment essential for background checks
- Information source: public domain or privileged information
- Risk disclosure to insurer may influence shareholders
- Claim validation and legal position must be scrutinised
- Possible media interest in sector or specific players
Risk

• Impossible to specify single peril or claim trigger (cause)
• Reputation ‘loss’ is consequential to an event (effect)
• Damage is caused by audience response to news
• Severity varies: outrage, disgust, concern, surprise etc
• No common cause but all damage/loss is ‘behaviour-initiated’
• Risk is typically an ‘unexpected surprise’ eg profit warning
Outage

- How do you measure damage to reputation?
- What can be irrefutably attributed to reputation damage alone?
  - Revenue outage
  - Opportunity cost
  - Crisis handling costs
  - Goodwill restoration
- Trust and confidence return naturally with time so....
- How do you fix the quantum loss or duration of damage?
• How do you provide evidence or proof of loss?
• Discrete external costs like legal or PR advice only part…
• Intangible costs: opportunity, goodwill etc are difficult to prove
• Future lost business is a contentious issue
• How do you prove the loss was not caused by the insured?
• Studies show the client often part of the problem not solution
Barriers to cover

Capacity
Hazard
Information
Risk
Outage
Notice
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