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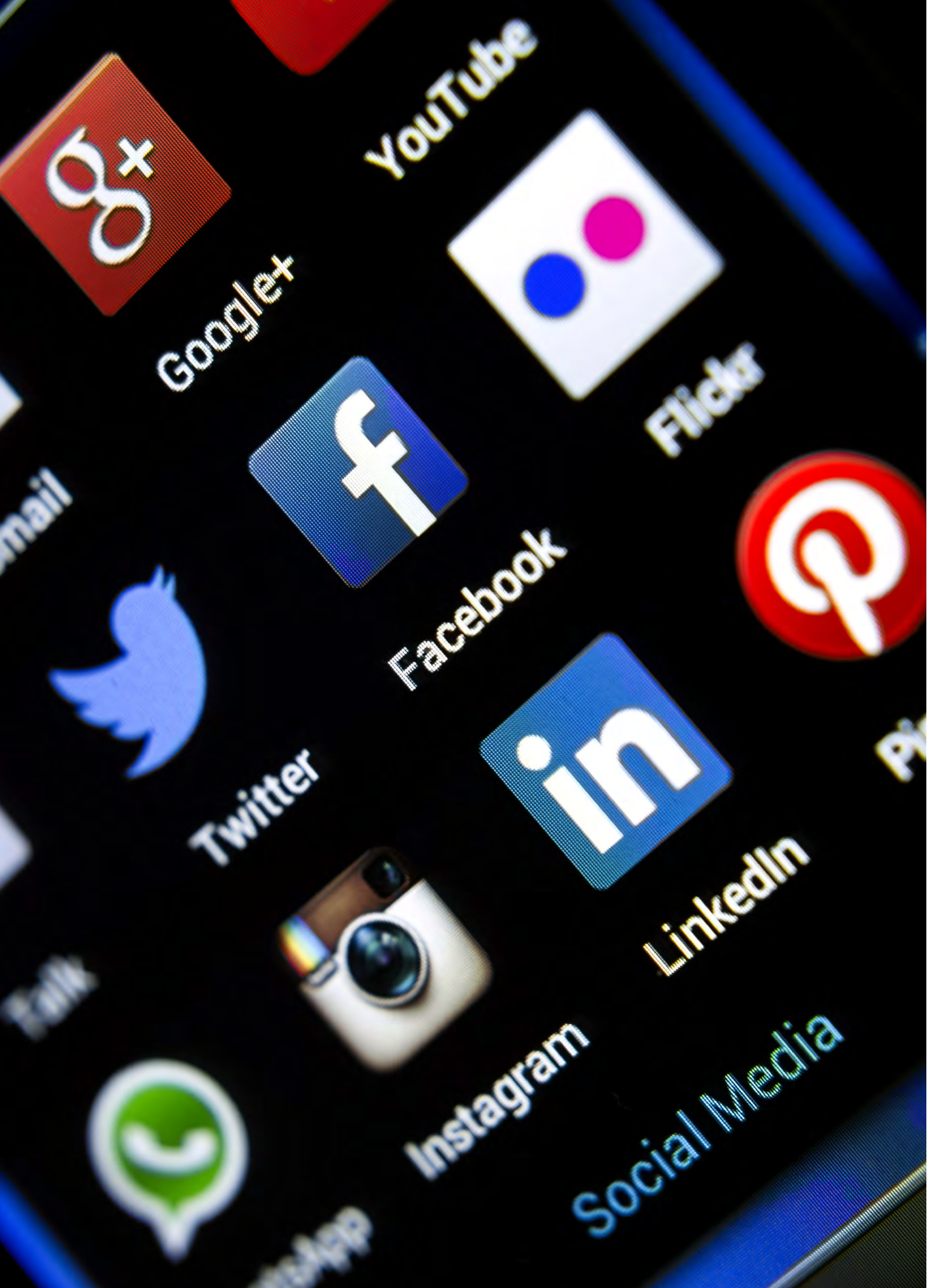
New Generation Programme | Broking Faculty | 2015

Reputation Risk in a Social Media Culture

How well is the insurance market responding?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Welcome from the Chartered Insurance Institute

This report represents the thoughts and ideas of the members of the Chartered Insurance Institute's Insurance Broking Faculty New Generation Group 2015 and I would encourage all those in the market – particularly underwriters – to act upon the report and start to develop the solutions that customers need.

The New Generation group members were challenged to identify a project of their own choosing that they felt could help drive change in the insurance profession for the ultimate good of customers. This is the result of their endeavours – and whether you agree or disagree with their findings and recommendations – the issue they have addressed, that of reputation for SMEs, is a real one - especially as SMEs are the backbone of the UK economy and most growing economies across the world.

The fact that this group of insurance professionals – the likely future leaders of the insurance broking profession – have identified this issue demonstrates that it is one that should not be ignored. It is only by tackling the real risks that customers face that the insurance profession can insure it is relevant in the future and that it is doing what it has done for centuries – which is support and facilitate the development of individuals and businesses by taking imaginative approaches to covering risk.

Ant Gould
Director of Faculties
CII

Foreword

I am delighted to write the foreword for this paper, because there is a need for action within the insurance industry when it comes to reputation risk insurance.

Companies are looking to insure against reputation risks, but they need better and more robust measures to work from. There is a need for an industry standard to quantify the reputation impact from negative events. Media exposure does not equal reputation loss, it can impact it, but the reputation damage only comes when people lose trust in the company. The good news is, the science is there to turn the intangible concept of reputation, into a tangible measure of reputation risk. Now it's time to take action!

To reach their business goals companies need support from a number of stakeholders. They need customers to buy and recommend their products, they need the regulators to give them a license to operate, they need the financial markets to invest in them, they need the media to give them fair coverage, and they need employees to deliver on their strategy. For all these people to do this, they are asking for one thing.

That they can trust the company. That the company lives up to its promises. That it has a good reputation.

Managing your reputation is critical to achieve business success. In today's complex and connected world there are more stakeholders out there who care about you as a company, and they can impact your business with a single click. They care more about what you do than what you sell. They care about how you operate as a company, and if they can trust you.

But how do you manage perceptions and feelings? How do you manage reputation?

Reputation is the perception others have of you. It's a feeling, which makes it intangible. And managing something which is hard to define is difficult. To understand reputation you need to make the intangible tangible. You need to break down your reputation into specific components that you can measure and manage. Then you are able to identify the specific impact from a crisis or an issue on your reputation and manage it.

Kasper Ulf Nielsen
Co-Founder and
Executive Partner
Reputation Institute

Kasper Ulf Nielsen is an Executive Partner at Reputation Institute. Over the past 10 years, he has been engaged in international reputation management helping companies in a range of industries including pharmaceuticals, information technology, food and beverage, public transportation, energy and financial services. Kasper is a frequent commentator on reputation topics and has been featured in The Wall Street Journal, Forbes, Bloomberg, as well as local radio and TV around the world. Kasper has made numerous presentations at international conferences on reputation management and has published a number of articles in Corporate Reputation Review. He is also co-author of the book Introduction to Organizational Theory published in 1999. Kasper holds a Master of Science in Intercultural Management from Copenhagen Business School with MBA credits from McGill University in Canada.

Reputation management starts with measurement. If you cannot measure it, you cannot manage it. Over the past 15 years Reputation Institute has studied how to measure and quantify reputation and reputation risk. Having a clear definition of what reputation is, and how to measure it allows companies to quantify the risk exposure within reputation.

So what is a reputation risk? Simply put, a reputational risk is an event that reduces the perception stakeholders have of your company.

This means, that the event only becomes a reputation risk if it impacts how stakeholders think and feel about your company. And this is a critical point, because this is the "trigger". When people heard about the event, did it change their perception? If it did, then there will be a loss, as they will buy less, boycott you, and say something negative about you. If they heard about it, but their perception did not change, then the event had no or very little reputation risk.

The RepTrak® model designed by Reputation Institute identifies the reputation risk of any event by determining the impact on the 7 dimensions of reputation. When a negative issue or crisis emerges, the question is to what extent it will reduce the perception of the organisation to deliver on the specific expectations within each dimension. In assessing this, you can assess the reputation risk of any issue.

1. Products & Services: Issues that will reduce people's belief that we deliver high quality products and services that are good value for the money

2. Innovation: Issues that will reduce people's belief that we are an innovative company that brings new products and services to the market first

3. Workplace: Issues that will reduce people's belief that we have the best employees and that we treat them well

4. Governance: Issues that will reduce people's belief that we are open, honest, and fair in the way we do business

5. Citizenship: Issues that will reduce people's belief that we are a good corporate citizen who cares about local communities and the environment

6. Leadership: Issues that will reduce people's belief that we have a clear vision for the future and are a well-organised company

7. Financial Performance: Issues that will reduce people's belief that we are a profitable company with strong growth prospects

So the definition of reputation and reputation risk is set, and the measures are here for companies to use. The only thing missing is agreeing on the measure to capture the negative reputation impact. When that is done the insurance industry can develop a credible product for reputation risk insurance on the market.

I encourage you to take that step, as this will help many companies move forward in this new and complex social world.

Introduction

A trusted reputation and strong brand have always been paramount to the success of any business.

With the advent of social media and global connectivity, incidents that have the potential to cause damage to a company's reputation have increased almost beyond comprehension.

Organisational behaviour and corporate social responsibility are under scrutiny by a technology savvy customer who has various mediums through which to expose a company to reputational damage – in some instances, by just a single 'tweet'.

A 2015 study by Reputation Institute in conjunction with Airmic found:

"Members report reputational risk as both their number one 'keep me awake at night issue' and a high concern for their executive management and Board". [1]

So how has the insurance industry responded? The insurance industry is quick to promote the idea that 'anything can be insured'. From celebrity legs to footballer's feet, the insurance industry can usually offer a solution in return for a premium. However, whilst a small number of insurers have adapted to the idea of covering brand and reputational damage, the difficulty remains in defining and quantifying the exposure.

Reputation is inherently intangible. Losses can arise as a result of many different events, which make brand and reputation risk a complex exposure for the insurance industry to subsume.

In many cases, customers themselves are unsure exactly what they want cover for; despite a recent report suggesting 81% of firms view reputation as their most valuable asset.[2]

Whether it is product recall, an employee's stray comment on social media, a disgraced celebrity endorser, or simply an unjustified review on trip advisor - the consequence can be devastating. In addition, the expectation around the role of the insurance market can vary greatly.

A large Plc's primary concern may be to protect their market capitalisation or revenue. Expert assistance in managing the unfolding crisis can often mitigate the potential damage – which is especially relevant for smaller firms unlikely to have the luxury of an in-house public relations function.

Determining the impact of an event in terms of claims quantum, to allow an insured to be indemnified for reputation damage is an altogether more complex affair.

Over the past eighteen months or so, there have been a significant number of articles within the insurance and wider press discussing reputation risk. Almost all point to a lack of response by the insurance industry, and the difficulties associated with providing cover for brand and reputation damaging events. Jason Eatock, Head of SME at Zurich insurance commented in the Insurance Times:

"While the market for reputation-related insurance products is becoming more relevant, it remains underdeveloped and in need of more options for businesses to transfer such risk".[3]

The purpose of this paper is to consider:

- The need for brand and reputational risk cover
- The barriers to insurer participation
- The level of coverage currently available
- How the insurance industry should respond

Recent examples of reputation loss

Damage to brand and reputation resulting from an incident reported on social media is a major concern for both SME and larger companies alike. As more and more people participate in social media, the intricate detail of any adverse incident can now reach a far larger audience - thus impact exponentially on a company's brand and reputation.

It comes as little surprise, that according to the Pew Research Centre, 52% of online adults now use two or more social media sites, up from 42% in 2013.[4]

A 2013 internet trend report by Kleiner Perkins Caulfield & Byer estimates that the typical smartphone user checks their phone 150 times a day and can spend up to 20% of their time on social networks such as Facebook, Twitter and Instagram.[5]

There have recently been a number of high profile incidents causing significant brand and reputation damage to the companies involved. These incidents have led to an erosion in share price, a reduction in revenue, a lack of customer confidence in the brand and often a damaging effect on corporate and social reputation.

Some examples include:

BP Deepwater Horizon Oil Crisis

The event itself was the biggest offshore environmental disaster in US history.

BP's lack of apparent empathy and compassion was personified by former BP CEO Tony Haywood who famously commented in an interview: "I'd like my life back". The interview was broadcast on global news channels and went viral on social media evoking a huge backlash of public resentment and anger.

Chelsea Football Club - Paris Metro

This particular example of brand and reputation loss demonstrates how a single event captured by camera phone can go viral on social media in a matter of hours. The incident involved a group of Chelsea fans racially abusing a commuter on the Paris Metro, refusing him access to a busy train.

Although difficult to quantify, Chelsea Football Club acted quickly to ban the fans involved in an attempt to mitigate any loss of reputation.

LG's mockery of iPhones backfires

When the new iphone was found to bend in peoples pockets, LG tried to make fun of Apple, tweeting from the LG France account that:

"Our smartphones don't bend, they are naturally curved ;)."

The only problem was that the LG tweet was sent from an iPhone!! The story trended on social medial within hours to the detriment of the LG brand.

Volkswagen Emission Scandal

The recent emissions cheating scandal involving Volkswagen has undoubtedly brought about immeasurable reputation damage to the worlds third largest car manufacturer. Arguably, the media coverage has been such, that damage to the Volkswagen brand would most likely have occurred with or without the propellant of social media.

Nonetheless, social media contributed to a larger audience becoming well informed of the situation as it unfolded.

Risk perception

An extensive amount of research and literature exists regarding the management of a company's reputation; most of which centres on public relations, marketing and finance.

That said, there has also been a wealth of research conducted around measuring corporate reputation led predominantly by Charles Fombrun, founder of the journal 'Corporate Reputation Review'.

The research and advisory firm 'Reputation Institute', of which Fombrun is also founder and Chairman, has been at the forefront of research into the tracking and measurement of corporate reputation since 1997. Their Reptrak product is used by many top FTSE and Fortune rated companies.

Kasper Ulf Nielsen, Co founder of the Reputation Institute commented that *"83% of consumers say they would definitely buy products sold by companies with top reputations while only 9% want to buy from companies with poor reputations"*.[6]

Research recently conducted by the 'Economic Intelligence Unit' and law firm 'Clifford Chance' found that:

"74% of UK board members see reputational damage as the most worrying consequence of an incident". This comes ahead of the potential financial costs, loss of business and even effect on share price.[7]

In relation to risk perception within smaller organisations, Zurich recently announced the SME results from their annual 'Risk Index' survey, conducted in conjunction with YouGov. The findings showed that Reputation Risk (involving online and social media) ranked second largest perceived area of business risk within all SME companies polled.[8]

Similarly, Research conducted by reputation management specialists, Igniyte found:

"Reputation risk is now the biggest risk concern, due in large measure to the rise of social media".

Many of the businesses canvassed had recently suffered significant damage to their reputation as a result of adverse social media coverage:

- More than half of those quizzed (52 per cent) reveal business had already suffered because of damaging posts. The content wiped out sales and company value prompting average losses of £46,815.

- Negative comment created by competitors is the most damaging, creating a problem for 43 per cent, followed by malicious postings from disgruntled former employees (affecting 42 per cent).

- Poor reviews are also causing problems for 41 per cent of businesses, while almost a third (30 per cent) feel their online reputation has been affected by the online activity of existing employees.

- Negative media coverage is also an issue for 17 per cent, while one in ten have suffered because of critical or offensive social media posts.

- The research, which took in the views of 500 UK business leaders, also finds that 88 per cent recognise that a positive online presence is of vital important to their customers.

- Almost one in ten (nine per cent) estimate to have lost between £50,000 and £100,000 as a direct result of negative content online, while close to a quarter (24 per cent) are up to £10,000 out of pocket.[9]

Much of the research cited is in agreement that the risk to a company's reputation and the rise in social media use is inextricably linked. Hill Dickson partner Magnus Boyd stated:

"*If reputation risk sits higher in people's minds or on risk registers now, it must be a reflection of the rise of the internet and social media*".[10]

In addition, the Guardian in 2014 stated:

"*In an age when any small misdemeanour can be magnified on the world stage in a matter of seconds at the click of a button, it is no wonder that despite their best efforts many brands have lost the trust of their consumer*".[11]

The evidence overwhelmingly points to the majority of business leaders being fully aware of the threat posed to their brand and reputation; many of these having had first-hand experience.

This growing concern has created demand for the development of an insurance based solution to mitigate against the risk of brand and reputation loss.

Barriers to the development of 'Brand and Reputation' insurance

There are a small number of insurance providers currently developing insurance solutions to assist firms with managing their brand and reputation risk. The extent of these solutions vary somewhat.

However, before discussing the current level of insurance cover available to mitigate brand and reputation damage, it is pertinent to set out some of the perceived barriers to entry faced by insurers.

The five barriers found to be most commonly cited can be categorised as:

1. Quantifying a loss
2. Moral hazard
3. Claims and pricing
4. Defining a trigger event
5. Lack of demand

1. Quantifying a loss

Arguably the most commonly cited barrier to insuring against brand and reputation risk is quantification. How can the loss of reputation or erosion of a brand, as subjective as they are, be put into 'pounds and pennies'?

How can an underwriter or loss adjuster assess such a loss, never mind accurately attribute a claims payment?

To fully estimate the impact of an incident, it would be necessary to understand - the loss in market capitalisation, deterioration in customer relationships, impact on potential investors and new customers, and even any fines and penalties that may be attributable.[12]

Whether through loss of custom, dip in share price, or inability to win contracts, any deterioration of brand or reputation will most likely have one common denominator - in the long term, a reduction in revenue. The extent of this impact can be minimised by effective risk management.

"*Drilling down further, it is clear that damage to customer relationships and the financial impact of reputational damage (for example, loss of earnings and the impact on share price) are the areas that executives worry about most*"[13]

Currently there are three insurers providing cover for loss of revenue resulting from brand and reputation damage, all with slightly differing methods of quantifying a loss (see page 14-18).

2. Moral Hazard

The Volkswagen emission cheating case noted highlights the potential 'Moral Hazard' involved in tabling an insurance solution for loss of brand and reputation.

Clearly it would be morally wrong to indemnify a person for knowingly acting in an unjust or illegal manner. Most existing insurance policies exclude any loss arising from an insured's wilful, deliberate, malicious, fraudulent, dishonest or criminal act. As a result this provides some measure of protection against moral hazard.

Whilst immoral acts can never be entirely eradicated, they can be mitigated and managed. A robust process of corporate governance embedded into a company's culture can effectively minimise such acts. A well communicated policy on the use of social media for instance, will ensure employees think carefully before engaging via social media.

Moral Hazards exist in other insurance policies and therefore this should not deter insurers from underwriting the risk.

Insurers should also aim to champion good corporate governance. For example, their work ingraining Employer's Liability coverage within the UK legal framework has created a wave of 'Health and Safety' regulations, which most firms take extremely seriously.

3. Claims and Pricing - The Unknown

Some studies have found a direct correlation between certain types of corporate misconduct, especially where the injured parties are customers - and the subsequent loss in equity a company may suffer (i.e. share value).[14] Whilst losses of this type may fall under the 'Moral Hazard' category, it demonstrates the unpredictable and disparate nature of potential claims.

As with all new and emerging risks, the types of claims together with their frequency and severity will undoubtedly be a challenge, especially for Underwriters applying a price, and Claims Assessors setting the reserve.

Cyber insurance provides an example of where the experience of claims and expertise around settlement is still in its infancy. Nonetheless, insurers have embraced cyber risk insurance and the product is largely available (although currently scarcely purchased in the UK).[15]

Capacity to pay claims is also a barrier to insurers developing Reputation Risk policies. The potential for large losses occurring is unknown due to a limited amount of publicly available data. Matthew Hogg, Underwriting Manager at Liberty Specialty Markets commented:

"Small companies won't pay for it, and large companies can't get the capacity they require in the market. The Liberty proposition is therefore typically targeted at mid-market sized companies:"[16]

4. Defining a trigger event

Of the few reputation risk policies currently available, most are triggered following a crisis event. The term "crisis event" varies between insurers, but generally a loss is triggered by one of the following:

1. An insurance claim under any other policy the insured has e.g. a public liability claim that has caused a drop in revenue.

The problem however is that 1) there must be a valid and paid claim, which may take significant time to agree, and 2) there must be an identifiable connection between the claim and the loss of revenue.

2. Adverse media event likely to cause loss of revenue to the insured, including social media.

This is a much wider trigger, as it is most likely that any adverse event reported in the media will have some impact on a company's reputation.

3. Specific listed perils such as death, injury, food poisoning, outbreak of disease, etc.

In all cases, the trigger must cause some form of financial loss, drop in revenues, a reduction in the share price, loss of suppliers, or loss of investors.

As with any insurance contract, the current policies available assume an element of insurable interest. With this in mind, it is likely that insurers would want to limit their exposure to industry wide events such as the horse-meat scandal, where the fault lay with the supplier.

That said, insurers offer property damage cover for widespread storm damage or pandemic incidents and outbreaks. Ultimately, it is the decision and responsibility of individual insurers as to how they manage aggregations of loss.

It is also the responsibility of the broker to fully understand their clients and to work with insurers to develop triggers, which would not only meet the insured's needs, but are reasonably foreseeable and of value.

5. Lack of Demand

The demand for brand and reputation cover is likely to be relatively similar irrespective of the size of business. Of course larger organisations are better known, further reaching, and likely to be more prepared for a crisis event - however as long as a company has a 'brand' or a 'reputation' to uphold, the demand for a solution to protect that brand and reputation will be present.

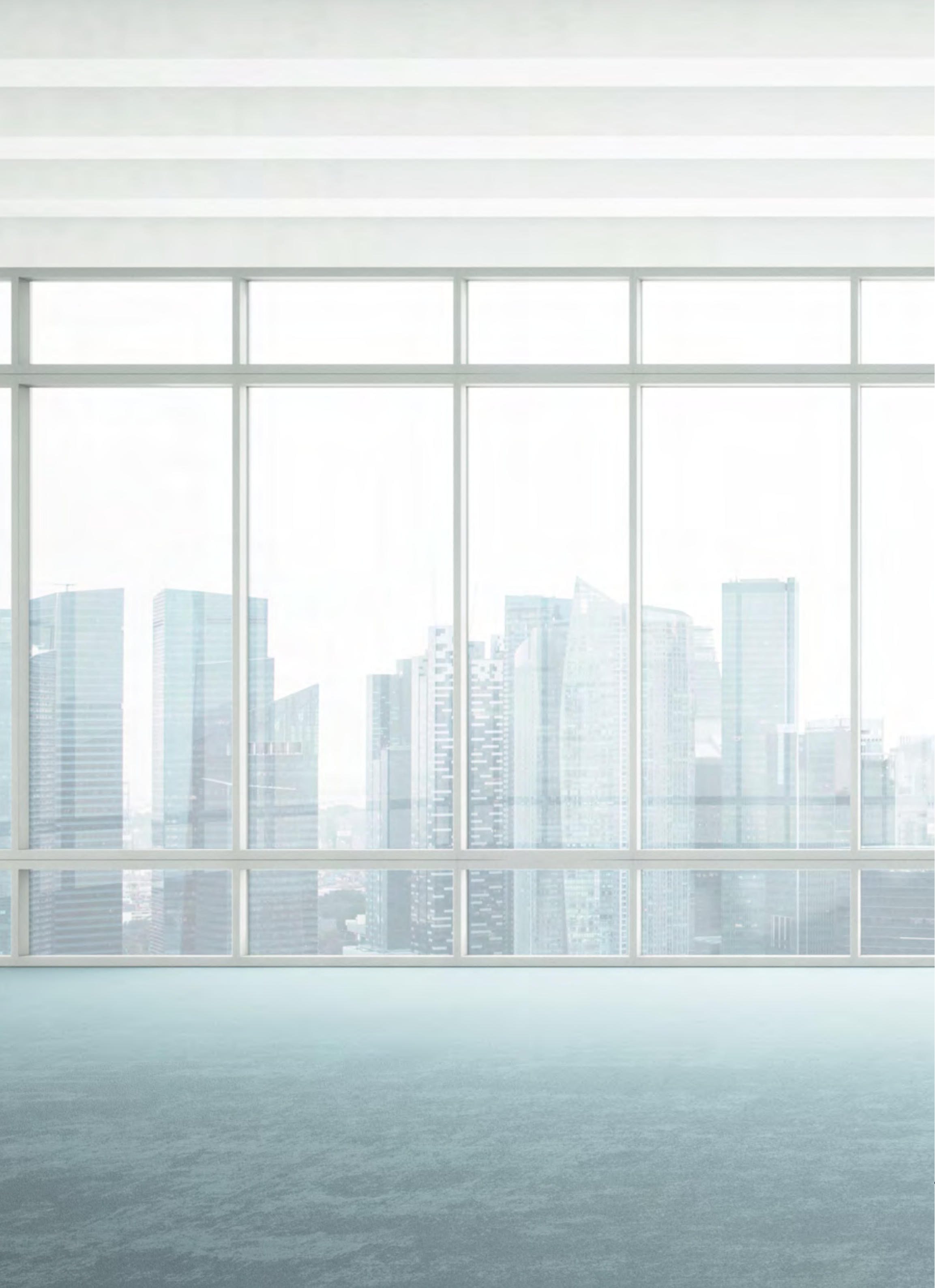
With the advent of the internet, companies however small can reach all corners of the world. Similarly, the potential for brand and reputation damage is ever increasing. Despite this, the assumption brokers commonly make is that there is very little demand in the UK for an insurance solution to cover brand and reputational loss or damage.

The issue however, may not be a lack of demand, but rather, a lack of discussion between broker and client around the risks associated with brand and reputation.

Again, parallels can be drawn with the introduction of cyber insurance over the past decade. Brokers have been slow to embrace the cover, resulting in low take-up levels. Poor claims data, a fear of catastrophic loss, and a general lack of understanding have also contributed.

Despite this, the status and profile of cyber insurance has recently been catapulted to the fore, due to swift technological web advancements leading to a spate of large losses worldwide.

The possession of a crystal ball may not be required to predict a similar chain of events with regards to brand and reputational risk cover.



Cover available within the UK insurance market

Based on our research, six insurers were found to offer an element of brand and reputation risk cover. The time-line on the following page shows when each insurer entered the market.

We were unable to obtain any written documentation, with insurers commenting that cover was offered on a 'bespoke' case by case basis, and as such, policy wordings were not available to share.

We outline policy highlights for those insurers currently offering some level of brand and reputation cover. The information builds on research conducted by the FAU in a working paper published in June 2014 entitled "Assessing the Risks of Insuring Reputation Risk".[17]

TIMELINE FOR THE EVOLUTION OF BRAND & REPUTATION RISK INSURANCE

Pre 2011

1. Crisis management costs provided as an extension to policies such as Cyber Liability, Kidnap & Ransom, Product Recall, and D&O.

2011

2. Zurich pioneer first stand-alone Reputation Risk cover with their 'Brand Assurance' policy in collaboration with Aon and marketing firm WPP. Cover extended to PR costs.

3. Chartis/AIG and Kiln follow suit, offering cover for PR costs resulting from reputation damaging events

2012

4. Munich Re introduce its "Reputation Risk insurance" policy in April 2012 which provides protection against loss of profit arising from a reputation damaging event.

5. Kiln in conjunction with Willis launch a product providing cover for both crisis management costs and loss of revenue. The policy is for Hotels only, called "Hotel Protection 2.0"

2014

6. Kiln launch reputation risk policy for the wider market, covering crisis management costs and loss of revenue. The policy is on a named perils basis.

7. Liberty Specialty Markets also begin offering a reputation risk policy covering crisis management costs and loss of revenue

	AIG	Allianz	TOKIO MARINE KILN
Covered Loss	Crisis management and communication costs. In response to a reputation threat (before event gets published) or reputation attack (after event gets published)	Crisis management and communication costs In response to a crisis event with the potential to adversely affect the insured's business reputation	Revenue loss plus crisis management costs in response to "adverse media event"
Limit	Variable aggregate, up to $25m	€10m aggregate	€25m aggregate
Deductible	Self-insured retention applies	None on professional fees For media spend, a contribution would be expected	Deductible applies, to be agreed
Coverage Trigger	No explicit trigger. Coverage starts when policyholder hires any of listed expert panel PR firms in response to reputation threats or reputation attack	Crisis event defined as "any established insurance trigger of any other insurance policy. e.g. a liability claim, D&O claim, property loss, with the potential to adversely affect the insured's business reputation	"Adverse media event" defined as publication of a statement regarding one of listed perils that has or is likely to cause direct revenue loss to insured
Insured payout	Costs of communication monitoring pre incident reported / crisis communication costs / social media response costs	Fees for professional crisis and reputation management and communications services	Loss of revenue which directly results from the incident
Key Exclusions	Criticism of financial performance or any change in the financial rating / an insured's decision to change any business strategy, manufacturing process, vendor, supplier or distributor	Known prior matters and notifications / wilful managerial conduct	Any peril affecting the industry broadly / wilful, deliberate, malicious, fraudulent, dishonest, or criminal act / Adverse media events arising from strikes or similar labour actions

	Liberty Mutual Insurance	Munich RE	ZURICH
Covered Loss	Coverage to protect earnings following any short to mid-term reputational damage as a result of an adverse media report. Crisis management expenses also available	Lost profits due to reduction in revenue in response to "covered risk event". Requires decline in consumer perception and change in consumer behaviour as well as related reduction in revenues	Crisis management consultancy fees In response to a "crisis event" that has or is likely to lead to "adverse publicity" within 60 days after commencement of crisis event and expected to lead to "financial loss"
Limit	$10m	€50m, in exceptional cases up to €150m (Possible to obtain protection against declines in turnover of significantly more than €1bn)	$100m aggregate with sublimits per crisis event / Emergency crisis event expenses sublimit = 50% of the premium for any single crisis event or series of related crisis events
Deductible	Risk dependent, no minimum	Typically at least 5% of limit	$1m anticipated for fortune 500 companies or comparable / $10k for middle market firms anticipated
Coverage Trigger	As a result of an adverse media report. Such a report may be factually correct or incorrect, on an issue that is listed as a named peril in the insurance contract. Named perils are agreed at outset	Option 1: all risks - Constant media analysis in target markets shows significant increase in negative media Option 2: Named perils Munich Re proposes six "basic events" Following the event, insured must experience a reduction in revenues as well as a decline in public perception	Crisis event defined as one of 19 named perils or "other events" (to be specified) that has or is likely to lead to "adverse publicity" within 60 days of the start of the event, and expected to lead to "financial loss"
Insured payout	The loss of Net Profit suffered by the Insured during the period of indemnity and/or any recoverable costs and/or any increase in cost of working incurred by the insured during that period, which is solely and directly attributable to the occurrence of one or other of the insured causes	Payout determined based on loss assessment result in combination with expected vs. actual revenue	Crisis management consultancy Extra expenses Pre crisis coverage
Key Exclusions	Risk dependent / typically matters that aggregate across an industry sector are excluded	Any event that is a direct consequence of a business decision of the policyholder's top and second management level / loss in revenue emanating from the non-availability of products due to physical damage at the premises of the policyholder/ supplier	Any dishonest act by insured, director, officer, employee of insured Certain defined cases of product Recall.

Summary of the cover provided

Zurich was the first insurer to develop a stand-alone Crisis Management policy to respond to reputation damaging events. The policy covers any crisis management consultancy fees and provides high limits of indemnity. Zurich do not actively market the product, it seems that it is reserved for only the very large customers.

Similarly, AIG and Allianz offer cover for only crisis management and communication costs in the aftermath of a reputation damaging event. AIG do however extend cover to provide similar costs prior to the event being publicised (but after its occurrence). As discussed, with the advent of social media reporting, this probably provides little additional cover.

Munich-Re provide cover solely for loss of profits following a crisis event. The policy requires a decline in consumer perception and change in consumer behaviour as well as related reduction in revenues. With the ability to provide protection against declines in turnover of significantly more than €1bn, this product is clearly targeted at the very large organisations with in-house public relations and communications departments.

Kiln and Liberty provide the most advanced products in response to brand and reputational damage. Both products are relatively new and provide cover for Loss of Revenue in addition to Crisis Management costs.

Both are on a named perils basis, where the insured can choose which types of events are included. From discussions with key underwriters at both Kiln and Liberty, the product is targeted at mid-market customers, with the price being currently out of reach of most SME businesses.

At the time of writing, Axa has extended its Management Liability policy for SME clients to cover public relations costs related to negative social media incidents.

In addition there has also been a recent influx in alternative capital available outside of the traditional insurance market. Potential therefore exists for brokers to utilise this capital to supplement existing cover and shape solutions for their clients.

Use of alternative risk transfer for brand and reputation protection

Most permutations of alternative risk transfer (ART) involve some form of capital outside of which brokers consider the traditional (re)insurance supply. For the majority, this alternative form of capital has been utilised in the reinsurance sector, taking the form of Catastrophe Bonds, Reinsurance Sidecars, Industry Loss Warranties and Parametric Covers, to name but a few.

These reinsurance deals tend to be far enough removed from the original risk to allow an element of diversification within a fund without adding an immeasurable amount of volatility. Indeed, the last few years have proved relatively benign in terms of insured losses, which has been a contributing factor to the market's influx of alternative capital. There are however, a number of instances where investors have opted to position themselves closer to the risk.

One such deal includes the much publicised Corney & Barrow weather derivative. Corney & Barrow found that champagne sales were directly correlated with temperature. Through a structured deal with XL Trading Partners, they were able to mitigate the volatility that weather variances could have on their earnings.[18]

This aside, there are few other examples of direct ART deals that have taken place.

So the question is, could a similar solution be found for brand and reputation risk? In today's market, there are two main issues for fund managers. These are volume and credible measurable data.

Volume allows alternative capital providers to operate above their minimum margin requirements, which far exceed the income derived from a small to medium commercial policyholder. Larger multi-national risks can circumvent this issue given the scale of operations.

However, where Corney & Barrow had statistics in troves, there is a lack of quantifiable brand and reputation risk data readily accessible.

Our view is that alternative capital providers will be unlikely to show interest in what is a relatively new and evolving risk. Historically, it has been the traditional (re)insurance market that has been central to the exploration and mitigation of unquantifiable risk; from the first Marine policies to the modern day cyber equivalent.

Traditional (re)insurers have positioned themselves at the forefront of risk – paving the way for credible and vast data stores from which alternative capital providers choose to operate. It is likely that brand and reputation solutions will evolve in a similar way.

Proposal for an SME solution covering 'Brand & Reputation' risk

Our research indicates there is a significant gap in the UK insurance market for brand and reputational risk insurance, especially for companies trading within the SME market segment.

The largest of companies generally have the means of self-funding the exposures they face, and a handful of insurers are providing some level of cover for the larger mid-market companies. However, SME businesses, that have a large exposure to brand and reputation damage, have been left exposed.

A collective arrangement to spread the risk

Cyber Insurance, as an example, has initially been slow to gain popularity. Take-up rates have been poor, although as previously mentioned we can see this beginning to change. One reason is that insurers have been reliant on a small number of brokers to sell the product. Unless brokers become more engaged it is likely that any attempt to market brand and reputation insurance will encounter a similar struggle.

We therefore suggest that an industry wide initiative involving all parties could help to champion the issue of brand and reputation risk, and bring new products to a much wider audience.

A possible option would be a large scale brand and reputation facility administered by an industry body, for example BIBA, CII, LIBA or similar. The facility could have an open panel of all specialist insurers willing to write brand and reputation cover at agreed parameters.

All major brokers would be able to sign up, and the result would be a collegiate pooling of risk across the insurance market. Insurers would offer an agreed amount of capacity, take on an equal share of the risk, and crucially share in the payment of claims thus mitigating the effect on carriers of catastrophic loss. Premium levels would reduce to a realistic level at which SME businesses could afford.

This could act as an initial solution to raising the profile of brand and reputation cover until the product becomes established. From there the market could revert to a more usual means of placement. Ideally we would get to the point where insurers felt comfortable enough with the risk to add the cover by way of extension to a Commercial Combined or Liability policy.

The Product – Brand & Reputational Risk Cover

An insurance product to cover brand and reputation risk should have four distinctive offerings:

Prevention

Pre-loss risk management and consultancy is imperative. Insurers must be comfortable that the company buying the insurance product has a suitable level of corporate governance in place. A social media usage policy should be a pre-requisite, training around brand management could also be offered.

Crisis Costs & Containment

The costs and expenses to employ a public relations firm to manage the brand's reputation during the adverse media period should be provided. All communications should be channelled through the PR firm in the first instance. A payment should also be made available to allow the company to mitigate any further loss occurring, not covered under a business interruption policy.

Resulting loss of revenue

An element of revenue protection would provide the basis of a marketable product, and a tangible level of cover which any insurance buyer would expect.

In order to quantify the revenue loss associated with a reputation damaging event:

A simple declaration of projected turnover at the beginning of the policy period compared with the dip in revenue following the reputation damaging event.

This would allow an underwriter or claims assessor to adequately settle a claim. For the sake of clarity, the insurer could agree that any loss of revenue following such an event, which is at odds with the projected turnover, would automatically be adjudged to be resulting from the reputation damaging event.

With an indemnity period, similar to business interruption cover, any period of sustained loss would be limited.

Post loss Risk Management & Consultancy

Assistance to help restore brand and reputation in the months after a loss is important. Insurers must provide this cover through in-house risk managers, or third party public relations firms.

Insurers should act in the best interest of the customer by assisting them as far as possible to mitigate any further damage. The insurer will still have a vested interest in their client recovering from any brand and reputation damage long after the crisis event.

Our conclusion - Insurance brokers must be more proactive

There are currently few insurers offering brand and reputation cover. Of the more innovative insurers willing to take on such risk, each one tends to target their products at the larger corporations. This has left an uninsured gap for the small to medium sized businesses. Ironically, it is the smaller and medium sized businesses that require the most assistance, as most will not have the luxury of a corporate communications department to mobilise an in-house crisis management team.[19]

The role of an insurance broker is one of advisor; to identify new and emerging risks, and to utilise the insurance market most effectively. Brokers must endeavour to fully understand their clients operations, and to base decision making on an analytical assessment of the risk. Three way engagement with insurers is imperative for the development of new and innovative means of risk transfer.

In 2013 John Nelson, Chairman of Lloyd's, stated in his speech at the Lloyd's City Dinner:

"There is an even greater need for innovation, particularly in terms of covering less tangible and new risks. One thing is clear, our customers have different demands to those which they had in the past. They are looking to this industry to find ways to cover new forms of risk".[20]

It is important to remember that insurance is not the only way to manage risk, and if the industry does not take the initiative, then other business models will emerge. Alternative capital must be better understood by brokers and utilised more regularly, not as a replacement for, but in conjunction with traditional insurance markets. This must be driven by insurance brokers, and traditional insurers must be encouraged.

In the same speech, John Nelson also commented:

"Brokers have always grown the insurance base. It wasn't the underwriters who spontaneously decided to write policies for Zeppelins, spaceships or cyber – it was because a broker came over to their box and asked them for cover". It is the brokers who are in the vanguard of developing business"

The coverage must be easy to understand, and this also has to be driven by brokers as the intermediary party best placed to communicate a company's evolving risk profile to the insurance market.

By its very nature reputational risks are intangible and thus it is even more important to set out exactly the cover a client requires. How a policy will respond in the event of a reputation damaging event should be clear to all parties from the outset.

Anthony Hilton writing in the London Evening Standard (2015) stated:

"Reputation has several components, and agreeing on what counts and what does not is an area of debate".[21]

An article in the Harvard Business Review cited:

"In an economy where 70% to 80% of market value comes from hard-to-assess intangible assets such as brand equity, intellectual capital, and goodwill, organizations are especially vulnerable to anything that damages their reputations".[22]

Firms spend millions insuring their physical assets so surely they need to start insuring the intangibles.

While a small number of insurers are beginning to offer various elements of brand and reputation cover, none have put together a product which offers a comprehensive solution. Crucially, none have yet been able to market a product suitable for small to medium sized companies, containing the four identified areas of assistance required:

- Prevention
- Crisis costs and containment
- Resulting loss of revenue
- Post loss risk management and consultancy

Brokers and insurers alike must work together with clients and customers to develop cost effective and comprehensive protection against the risk of brand and reputation damage. Social media use is rapidly increasing and before long, as we have seen with cyber risk, an influx of losses will begin to occur.

When that happens, as an industry, we simply must be ready to react.

Summary of recommendations

- First of all, and arguably most importantly – Data capture and collection must develop to allow quantification. Insurers and brokers alike must co-ordinate a shared approach to recording loss data.

- Brokers must become far more proactive. In their role as risk-advisor they should discuss brand and reputation risk with their clients as a matter of course. In turn, we will undoubtedly see a raised awareness - and demand for protection will of course increase.

- Development of a comprehensive 'Brand & Reputation' solution should offer four distinct areas of protection:
    1. Prevention Risk Management
    2. Crisis Cost & Containment
    3. Indemnity Protection for Loss of Revenue
    4. Post Loss Consultancy

  SME companies may benefit from a suite of products with which they can pick and choose, depending on their requirements and budget. Insurers should be flexible in this respect.

- In the absence of an insurer developing a product as described above, the Insurance industry should collectively assist. We suggest a facility to allow the pooling of 'Brand & Reputation' risk across the UK. Ideally administered by a partisan industry body, this facility would allow brokers to place risks through a panel of insurers. Insurers would offer an agreed amount of capacity, take on an equal share of the risk, and crucially share in the payment of claims thus mitigating the effect on carriers of catastrophic loss. This would kick-start a solution which otherwise may take decades to develop, and crucially, premium levels would reduce to a realistic level for SME's.

- Once the Industry becomes more comfortable with brand and reputation risk, and as data becomes available, the industry would revert to a more traditional distribution model. This would allow for insurers to begin offering 'Brand & Reputation' cover by way of an extension to Commercial Combined or Liability policies. In the mean time more insurers could provide policy extensions to assist SME companies in prevention, mitigation and crisis management.

Next steps

When assessing the market appetite to take on emerging risk, history tells us that as a whole, the insurance industry lacks innovative thinking. Whether it be the reactionary discussions currently being had around peer-to-peer technology or a quick analysis of the prolonged difficulty in ‘rolling-out’ cyber risk insurance - it is not unfair to say, that the insurance industry must become far more pro-active.

As a group of ten industry peers working for different organisations, we have all immersed ourselves in researching brand and reputation risk over the last nine months or so. Specifically due to the rise in use of social media, we can rightly describe the issue as a rapidly emerging business risk - one which we are committed to seeing the industry tackle.

This report hopefully serves as an opener, to give readers a flavour of a topic they may not have previously considered. We understand the limitations of the project thus far, and the need to engage the wider insurance market if we are to drive our recommendations forward.

The next steps for the group are currently well underway. We have made contact with some key industry leaders and are, at time of writing, awaiting face-to-face meetings with potentially interested underwriters.

As a side, we are approaching a range of SME insurers to assess the likelihood of adopting greater levels of cover by way of extension under already existing policies.

Our immediate aim is to obtain support for our recommendations, in addition to discussing any alternative ideas from the key insurers highlighted within our report.

We look forward to providing a follow up paper highlighting our progress in the near future.

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