MARSH

INSIGHTS | MAY 2018

Directors' Risk Survey Report 2018

Key Risk Concerns for Directors

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Foreword

Two key themes ran through our fourth Directors' Risk Survey Report – IT and people.

From external, to internal, to emerging risks, directors expressed their concerns about cyber, IT disruption, the loss of a key person, talent attraction and retention.

From the first survey in 2013, cyber risks were perceived to be an emerging risk – not one that was having an impact on entities on a daily basis. Leap forward five years and cyber is the number one external risk and the number one emerging risk. This is a similar trend that is being experienced globally.

In addition to cyber we are now faced with a new array of emerging risks from disruptive technologies. Artificial intelligence, blockchain and robotics are all set to interrupt and/or revolutionise the way we do things. Often referred to as the Fourth Industrial Revolution, these innovations bring with them a new set of risks from a governance and societal perspective.

In fact, the 2018 World Economic Forum Global Risks Report highlighted the need to manage this technological change saying that the "speed of disruption is destabilising", with artificial intelligence in particular presenting risks based on its decision-making powers with security and safety consequences.

Disruption to your business following a major IT incident involving loss of data, data corruption or failure of systems security also featured highly. Legislative changes enforcing mandatory notification of data breaches in the European Union, Australia and proposed changes in New Zealand are going to have an impact on how organisations protect and manage these data incidents in the near future.

An organisation's most important asset, people, is also a big area of concern for directors. The loss of a key person was the largest internal risk, with talent attraction and retention featuring in both our top five internal and emerging risks.

According to an ACC BERL report, the number one reason small businesses in New Zealand stop trading is due to injury and illness. This is due to the fact that many SMEs are owner-operated and there is no back-up if they become incapacitated. Larger organisations that have colleagues with a very specialised skill set or are in control of a project, which cannot easily be replaced, are also not immune.

Nearly a third of our survey respondents stated that they did not have plans in place to manage this risk. With many business owners being baby boomers, thinking about a succession plan for your retirement or in the case of illness is imperative.

In regards to talent and attraction, the tight labour market and a more competitive workplace means that organisations really need to step up their game. Mercer's 2017 Global Talent Trends Survey found that to attract and retain talent, it is necessary that organisations progress and look towards the future – which is about the "personalisation of the employee experience". They need to start by taking a "whole person" approach and increasing the flexible work options available to their workforce. This type of personalisation is what it's all about for people – meeting them where they are at in terms of their life stage and interests.

As they say, a failure to plan is a plan for failure. As with any business risk, planning and preparation is key. Keeping on top of the key trends impacting your organisation and looking at strategies to mitigate the risks that come from these will stand directors and boards in good stead for the near future and beyond.

Finally, a big thank you to everyone who took the time to participate in our 2018 survey. We know your time is precious and this report could not have been completed without your valuable input.

We hope you find these insights useful and wish you all the best with the remaining year ahead.

Marcus Pearson
Country Head, Marsh New Zealand

Introduction

Marsh is pleased to present our fourth Directors' Risk Survey Report in partnership with the Institute of Directors (IoD).

The survey was conducted in March 2018 with 570 members completing it. This is a great response, which has provided us with a wide range of insights.

As this is the fourth directors' risk survey we have run, we are able to benchmark the results with previous survey results. This will enable readers to see how things have changed in the New Zealand landscape, as well as review the latest results and discuss what directors' current and future risk concerns are.

The report is split into four sections covering personal risks, internal and external business risks, boards' involvement in risk and emerging risks.

Personal Risks

Directors are facing an increased amount of personal and professional liability, that is also becoming more and more complex.

Respondents were asked to rate their concern around three personal key risk issues as high, medium or low.

- Reputational risk surrounding you as an individual was the biggest concern with 57% of respondents rating the risk as high.
- Being held personally liable for a legislative breach was rated high by 37%.
- Loss of your personal assets if called to account was rated high by 37%.

Directors' and Officers' (D&O) Liability Insurance

D&O insurance is just one way that you can help to protect yourself from claims or allegations made against you. Are directors confident however that they have the right amount of cover and that they actually understand what is in the policy?

The biggest area of concern was "The policy not responding in the event of you needing to make a claim" with 31% of directors rating this of high concern. The issue of least concern was the cost of the insurance premiums.

In regards to understanding what was in the policy only 17% of people had a high concern with "not knowing what is in the policy", while 45% rated it as a low concern.

These responses are fairly consistent with our other surveys, suggesting that most directors feel a level of comfort with the policy contents – there is just a concern about whether the policy will respond if needed.

RANKING OF ISSUES SURROUNDING D&O INSURANCE

1. **The policy not responding in the event of you needing to make a claim**
2. **Lack of clarity about policy terms**
3. **Not knowing what is in the policy ie it is organised by another party – such as the organisation you are working for**
4. **Not having sufficient cover in your D&O liability policy**
5. **The cost of the insurance premiums**

Organisational Risks

Directors were asked about the risks impacting them from an organisational perspective. The areas of concern were split into external and internal facing risks.

External Risks

Cyber risk the biggest threat

For the second year running, cyber was considered to be the biggest risk affecting NZ businesses with 86% rating cyber risks as medium or high.

This result is very consistent with two other surveys that have recently been run here.

The World Economic Forum Global Risk survey ranked cyber as the third greatest risk for NZ, while 60% of respondents to the Global Cyber Risk Perception Survey, run by Marsh and Microsoft, said that cyber was in their top five risks.

Nearly 30% of those surveyed, said that they did not have an effective risk management framework in place to manage this risk.

Part of this could be due to not knowing where to start. Key findings from the Global Cyber Risk Perception Survey were that only 35% of NZ respondents were highly confident in understanding and assessing their cyber risks, 43% of respondents did not assess the cyber risks of their vendors or suppliers and 20% did not know if they were even exposed to any risks from their supply chain.

Boards must not only feel confident that there are plans in place to address and deal with cyber attacks, they must also understand the implications from the same happening to a supplier or vendor.

Suppliers can be used as a "back door" to get into a larger, more high profile organisation. Attackers often identify smaller business partners that are typically less well protected to get to a bigger target.

In the IoD's 2017 Director Sentiment Survey, 50% of boards had discussed cyber risk in the previous year and 45% said they had received comprehensive reporting from management about breach risks and incidents and actions taken to address them.

RANKING OF EXTERNAL RISK ISSUES

1 **Cyber**

2 **Brand and reputational risk**

3 **Disruption to your business following a major natural catastrophe, such as earthquake, flood or extreme weather**

4 **Financial risks**

5 **Increased competition**

Another report by Marsh & McLennan and FireEye, released at the World Economic Forum in January, identified two trends that are further complicating this new cyber reality. First, new regulations in Europe and elsewhere will require companies to undertake more rigorous security practices to protect data and systems. Second, attacks are growing increasingly destructive – threatening not just digital assets but property damage and bodily injury in areas such as ransom attacks on healthcare providers.

Organisations need to work as a team to effectively manage these cyber risks. By sharing oversight responsibility among stakeholders – including boards, C-suite executives, risk professionals and IT professionals – the managerial and technological challenges presented can be reduced.

Brand and reputational risks

Brand and reputation risks have increased in concern since the last survey was run, moving from third to second spot. 82% rated this risk as medium or high compared to 75% in our February 2017 report. Nearly 75% of those replying said that they did have an effective risk management framework in place to manage this risk.

Rumour and allegation are not new problems for companies, but in today's world, the rapid spread of information can happen within hours and be more challenging to overcome.

With a greater propensity for intervention and volatile social issues, it is unsurprising that reputational risks have become more prominent again.

Organisations should re-evaluate whether they are doing enough to protect and manage their reputation with customers, employees and other stakeholders.

Natural catastrophes

Disruption to your business following a major natural catastrophe, such as earthquake, flood or extreme weather was the third highest risk in 2018.

The prominence of natural catastrophe risks is of no surprise given the recent events we have had across NZ over the past few months. Storms in January, Cyclones Fehi and Gita in February and Cyclone Hola in March have already created a large impact and winter hasn't even begun.

It has been an expensive start to the year with the large storm in January that hit Coromandel and the Bay of Plenty likely to cost more than $26 million. Cyclone Fehi, which caused widespread wind damage and flooding in exposed coastal towns, and resulted in Dunedin and Buller announcing states of emergency, is expected to cost upward of $39 million.

In fact, insurers made losses of more than $242 million in 2017 for extreme weather events alone, according to the New Zealand Insurance Council.

Organisations seem to be well prepared to manage natural risks such as these with 81% saying that they have a plan in place.

Internal Risks

People and IT at the fore

People and IT-related issues dominated the top internal risks for 2018.

In our last survey, IT disruption was perceived to be the greatest risk followed by inadequate succession planning. This year, the loss of a key person is being seen as the most concerning risk with nearly 83% of respondents stating it is a medium to high risk. 32% of those surveyed said that they did not have plans in place to manage this risk, which is quite surprising.

The death or permanent disability of a key person can have a significant impact upon the continued success of a business. It can cause major financial loss, loss of confidence in employees due to lack of leadership and the opportunity for competitors to take advantage of the issues being experienced to snatch market share. SMEs are particularly vulnerable in this area.

Having succession planning in place is an important part of managing this risk. You can also provide financial protection by taking out key person insurance.

Talent attraction and retention is another people risk that is high on the agenda for directors. The subject was highlighted as the top risk in the IoD's 2017 Director Sentiment Survey under the heading of "labour quality and capability".

Only 68% of organisations have procedures in place to manage their talent risks. Given current labour shortages and the ability of organisations to attract and retain talent it is hard to understand why 32% of these entities are unprepared to manage the issue.

Having a work environment with a social conscience, that embraces diversity and inclusion, has a strong culture, flexible working conditions and a programme of employee benefits to meet the needs of the changing workforce will help. These are part of the new wave of "personalising the employee experience" and supporting people where they are at with their different lifestyles and interests, according to Mercer's 2017 Global Talent Trends Survey.

Disruption to your business following a major IT disruption eg software failure etc and loss of data, data corruption or failure of systems security or website security were ranked second and third respectively.

RANKING OF INTERNAL RISK ISSUES

1. **Loss of a key person**
2. **Disruption to your business following a major IT disruption eg software failure etc.**
3. **Loss of data, data corruption or failure of systems security or website security**
4. **Other**
5. **Talent attraction and retention**

Losing client data into the public domain is a nightmarish thought for many organisations – especially where the data has a sensitive nature.

As with the European General Data Protection Regulation that came into force in May 2018, NZ is currently reviewing its Privacy Act to ensure that it keeps pace with changes to information and communications technology. We anticipate therefore that there may be mandatory reporting of data breaches as part of this review.

The majority of organisations said that they had procedures in place to manage their IT risks. 87% said this was the case with disruption to your business following a major IT disruption eg software failure etc and 86% with loss of data, data corruption or failure of systems security or website security.

Risks of concern noted in the "other" category ranged from changes to Government funding and policies, health and safety, privacy breaches, lack of board technology and risk management understanding to operational failures.

Board's Involvement in Risk

One of the key focus areas of the report was to examine how the board's role has evolved in terms of risk management.

Only 68% of directors said that their organisations had a clear board approved risk strategy.

For the 23% of those that said they didn't, and the 9% that were unsure, there were several barriers as to why there wasn't a strategy in place.

For over a third of respondents it was simply around the fact that other areas have greater priority while 20% stated that they had a general lack of awareness of key risk management concepts. Other barriers were around lack of resources, lack of senior management commitment, inability to model the magnitude of the risk and applying the current risk management framework to new risks.

One easy step to start addressing these barriers is to commence open discussions with your managers and advisors regarding loss scenario planning.

Responsibilities and meetings

Who has the ultimate responsibility for developing and implementing risk management procedures in an organisation? 49% of respondents said it was the board of directors and 26% the CEO. Some members commented that this should be a combination of both. This view has not changed from previous surveys where the results were almost identical.

Similarly, there has been little change to how often directors engage at a formal board meeting. 36% of boards are meeting quarterly, 26% monthly and several commented that they meet bi-monthly.

Level of board engagement

53% of directors said that their board's involvement in insurance and managing risk had increased over the last 12 months.

When reviewing the reasons why this was the case, 42% said that their board had an objective to become more actively involved in risk while 29% stated that it was due to greater perceived risks in the current business environment.

NZ boards' involvement in risk correlates with a 2018 survey run by the National Association of Corporate Directors in the United States, which found that "an atmosphere of risk and uncertainty is driving directors to seek a deeper involvement in strategy."

In our last survey, members indicated that the key reason for their increased engagement in risk was due to the impact of the Health & Safety legislation on directors' liabilities, with the board's objective to become more actively involved in risk ranked third. It would appear that directors now have a greater level of comfort around health and safety and are therefore more focused on managing the wider range of current and emerging risks at play. This is aligned with the IoD's Director Sentiment Survey, which found that 76% of boards now felt that they had the capability to comply with the Health & Safety at Work Act.

69% of directors said that they were reviewing risk more than two years ago, which would indicate that the business environment has become more diverse and complex.

68%

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53%

of directors said that their board's involvement in insurance and managing risk had increased over the last 12 months

49%

of respondents said it was the board of directors that had ultimate responsibility for developing and implementing risk management procedures in an organisation

Emerging Risks

The main / future emerging risks, that may have an impact on directors and the organisations they work for in the next 24 months, was the final section in the survey.

As with the biggest external risk currently facing organisations, cyber was considered to be the biggest emerging risk with 78% of respondents.

Similarly talent attraction and retention, which was ranked the fifth biggest current internal risk, looked to be growing in prominence as the second largest emerging risk.

These results are markedly different from our last survey which ranked social media in the top spot and cyber in fifth place. Talent attraction and retention stayed at number two in both surveys and earning volatility in fourth spot. Moving into the ratings, at number five this year, was the impact of disruptive technology.

These trends are also reflective of the National Association of Corporate Directors survey in the US, where cyber security threats and competition for talent featured in the top five trends "having the greatest effect on your company over the next 12 months".

Last year we saw a lot of prominence placed on social media with some of the big elections around the world and various other geo-political issues. Whilst social media still has a big part to play in society and the business environment it is very much driven by what is happening in the world at the time. Hence some of the issues are not as heightened as they were a year ago.

The issue of social media is of course very much tied into corporate and reputational risk and thus having a plan to deal with any related issues should they arise.

According to the 2018 Global Risks Report, the speed of disruptive technologies is de-stabilising. Artificial intelligence presents particular risks based on its decision-making powers with security and safety consequences. Cyber-attacks continue testing critical infrastructure as well as commercial ventures and are becoming more extensively used by states and terrorists against their enemies.

This huge pace of technological change means that we must become alert and ready to adapt.

The impact on any company's financial performance, earnings, shareholder equity and company value can be swift and brutal.

A thorough characterisation of the top emerging risks involves assessing what's shaping each risk, their likely trajectory and its potential consequences, with a view to determining where it might touch the organisation, the types of impact and the time profile of the damage.

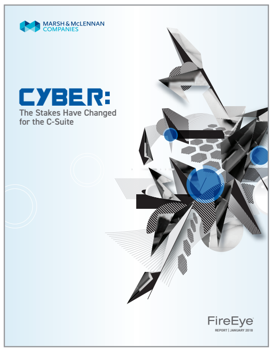
RANKING OF EMERGING RISK ISSUES

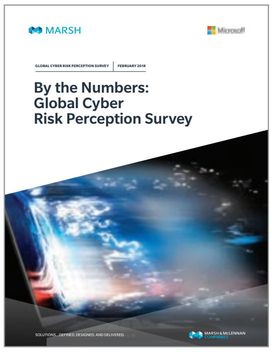
1. **Cyber risks**
2. **Talent attraction and retention**
3. **Increasing influence of social media**
4. **Earning volatility**
5. **Impact of disruptive technology**

Additional Insights

This survey and report are part of the thought leadership that Marsh & McLennan Companies produce each year, which includes research, insights, events, and occasional commentary on current items of interest to our clients. All of these reports have been referenced in this survey.

- World Economic Forum: The Global Risks Report 2018.
- MMC CYBER: The Stakes Have Changed for the C-Suite.
- Mercer Talent Trends 2017 Global Study.
- Marsh Global Cyber Risk Perception Survey.





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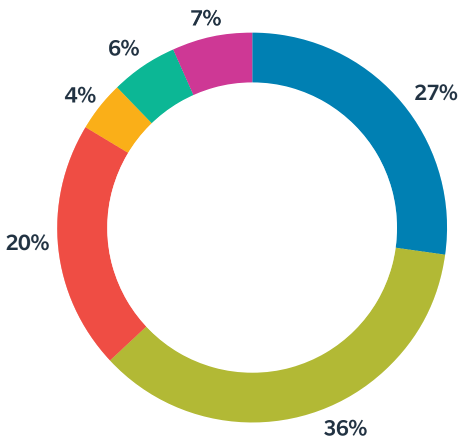
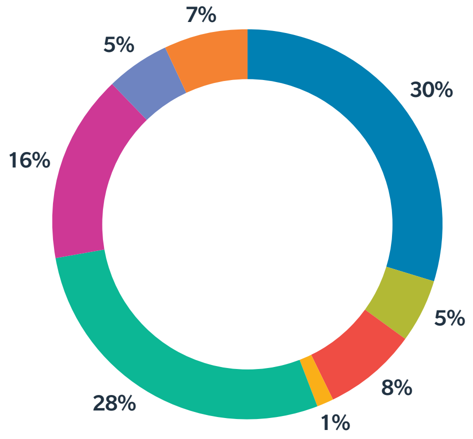
Survey Demographics

Respondents by Type of Directorship



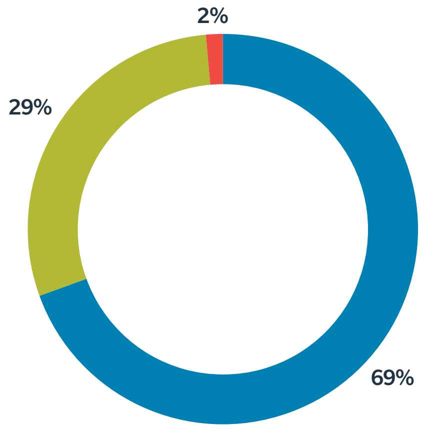
- Independent professional director for more than one organisation
- Director for a private company
- Director for a non-for-profit organisation
- Director for a government entity / state owned enterprise
- C-suite
- Other

Respondents by IoD Branch Region



- Auckland
- Waikato
- Bay of Plenty
- Taranaki
- Wellington
- Canterbury
- Nelson Marlborough
- Otago Southland

Respondents by Gender



- Male
- Female
- Prefer not to say

FOR FURTHER INFORMATION

For more information about this survey or any general enquiries about your risk and insurance programme, please contact Marsh on:

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