Leading insurers address reputation and its risks

Insurance Governance Leadership Network

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Reputation has long been thought of as the cornerstone of any brand. Traditionally, it has been an important sales, marketing, and recruitment tool. But in the current environment, reputation has increasingly become not just an asset but also a risk to be managed. This is most true for those companies whose reputations are built on work that could endanger human health or well-being. Reputational risk, in turn, can threaten the company's well-being and even its existence. Recent reputational challenges in the pharmaceutical, energy, financial services, and food sectors underscore this point. Although reputational challenges have arisen in the past, the viral nature of modern communication has radically changed the dynamic for large public firms.

"It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently."
– Warren Buffett

On June 11, Insurance Governance Leadership Network (IGLN) participants met in New York to explore reputation, its risks, and the role of boards in addressing it. For a list of meeting participants, see Appendix 1. This *ViewPoints*[1] provides a summary of these discussions and is guided by the following questions:

- Is reputation more important today than in the past?
- Why is reputation so difficult to manage?
- How can companies more effectively govern reputation and associated risks?

Is reputation more important today than in the past?

"All boards see reputation as their responsibility, but it didn't previously enter into strategic discussions the way it does today," said one director. Several insurers called reputation their greatest asset. *"From an insurance perspective, unlike manufacturing, we are selling a promise that if this happens, then this is what we will do. You get a piece of paper and a promise. Reputation is your most important asset. If you don't deliver on that promise, that is it,"* said one executive. There is no question that reputation is, and has always been, critical to the long-term health of all insurers.[2]

Aon's recent global risk management survey listed damage to reputation and brand as the number-one risk. [2]

"The difference is that today risks can come from anywhere, and the Internet and social media allow problems to spread incredibly fast," observed one director. According to several participants, modern-day reputation events have the potential to be larger and have a greater impact than similar events in the past.

Possible effects of reputation events

An event that damages the company's reputation can have knock-on effects in numerous areas:

- Customers: damage to existing customer relationships or loss of lead generation
- Financial damage: fall in valuation or share price, loss of earnings, loss of investors
- Talent: loss of existing talent, challenges in recruitment and ability to attract new talent
- Legal and regulatory effects: Increase in litigation, increase in regulatory scrutiny and fines

Reputation risk may also be rising on the risk radar because the art and science of reputation management has evolved dramatically in recent years. In the last decade, companies have developed new forms of reputation metrics. The surveying of stakeholder perceptions has also evolved. Both kinds of measurement allow for better quantification of a form of risk that has historically been difficult for management and boards to get their arms around.

Why is reputation so difficult to manage?

While reputation has risen on executive and board agendas, IGLN participants acknowledge that it remains difficult to define, understand, and address. Reputational risk has been broadly defined as the gap between the public's expectations for a company and the company's actual behavior. But understanding how and why reputations shift in the eyes of the public is complicated. Furthermore, unlike with other forms of risk, the triggers for a reputation crisis are not clear-cut: public perception of ordinary corporate actions, even in the absence of law or rule violations, can cause a company's reputation to plummet. Stakeholders' increased interest and stronger views on insurers' environmental, social, and governance practices are also creating more opportunity for stakeholder disappointment, which may lead to reputation incidents and ultimately to financial damage. For example, increasing concern in developed countries over the plight of workers in developing countries has led to criticism of numerous organizations, including Apple, Samsung, Mango, and the International Federation of Association Football. Sometimes the consequences can be severe: in 2014 Brendan Eich, the CEO of Mozilla, resigned less than two weeks into his tenure amid controversy over his donation to an anti-same-sex-marriage campaign.

"Reputations are quickly lost and slow to recover. Reputation can be destroyed fairly or unfairly."

– Executive

Participants identified characteristics of reputation that make management of risks related to it difficult:

- **It is a meta- or second-order risk.** Reputation risk can be viewed as a "meta" risk – the risk of risk itself. Alternately, one chief risk officer (CRO) defined it as *"the by-product of all other risks."* As a by-product or second-order risk, it amplifies the ill effects of primary risk events, such as misselling, bad management, ethics violations, or a catastrophe.

- **Firms have a growing number of stakeholders.** One executive said his reputation ecosystem includes customers, shareholders, regulators, politicians, ratings agencies, media, employees, and the wider public. Total reputation risk is the sum of the expectation-performance gaps for the entire group of stakeholders. What's more, none of these stakeholder groups is monolithic, so perceived corporate failings may vary within individual stakeholder groups as well as between them. One director highlighted this challenge: *"I think our reputation has never been better with commercial clients. On Main Street it is a different issue."* On the decision to retain a tarnished brand name, one director noted, *"We mainly sold through brokers, and they loved our brand. Others did not. So we kept the name and took the bold step of rehabilitation."* While each stakeholder group presents challenges, there was near universal agreement that managing the media can be extremely difficult. One director observed, *"The media has a nasty streak. Reputation destruction has become a national sport."*

- **Reputation is an intangible, essential, and expensive asset.** While reputation may be an insurer's most important asset, it is intangible, and one director acknowledged, *"Reputation defies easy quantification. How do you measure what it is or what it could have been after you've lost it?"* Most directors agree that even without a price tag, reputational damage is very expensive. And reputations are slow to build but quick to lose.

- **It is a function both of individual company behavior and of industry stature.** Reputation is affected not only by the activities of the company and its individual employees, but also by the actions of competitors and the sector as a whole. One director said, *"Every insurer, regardless of the business, probably took a hit after the financial crisis."* Across several meetings, participants have acknowledged that the industry's noble mission – to help build safety and wealth – is often at odds with the public perception of financial institutions as self-interested and greedy.

- **It is vulnerable in an era of viral communications.** The digital era has dramatically expanded the speed and reach of communication, allowing events to become public and to spread in ways that were not possible even just five years ago. *"We now have teams to monitor social media. You have to, or things can get out of hand very quickly,"* said one executive.

- **There are numerous risk drivers within and outside individual firms.** Since reputational risk can make other risk events even worse, the entire risk list could be viewed as potential drivers. While not all negative events ultimately tarnish reputation, participants highlighted several that are likely to.

Common reputational risk drivers

- **Scandals and disasters.** Scandals have rocked many industries, bringing more attention to reputation. Trust in large public corporations is at an all-time low, which may prime certain stakeholders to expect and even seek out reputation problems. *"It seems like there is a growing sense that corporations are evil. That is the baseline,"* said one director. Diverse examples of reputation problems include BP and the Gulf Horizon spill, automobile and food recalls, Libor and foreign-exchange scandals in banking, and the corruption charges that have been leveled at several multinational firms.

- **Sales practice and conduct.** Regulators and insurers are heavily focused on conduct and culture within the largest firms. One expert noted, *"Underpinning everything is culture. You can't eliminate reputation risk, but if the culture isn't right, you will certainly have problems."* Misselling scandals, insufficient consumer protection, and unhealthy culture are important sources of reputation risk.

- **New products and markets.** An increase in unknowns, such as come with newer products and markets, can lead to reputational surprises. A lack of understanding about product performance, underwriting, or culture in a new market increases risk. Several participants highlighted this risk with respect to serving millennials. One director observed, *"When we talk to Gen Y about contract terms, they don't understand things like third-party liabilities. Our language is not consumer friendly, and we don't use words that this generation is familiar with, which will lead to mistrust."*

- **Compliance and regulatory failures.** Regulatory or compliance failures are *"fodder for the media,"* said one director. They can damage reputation across stakeholder groups.

- **Weak internal communication and coordination.** When different business units or decisions fail to coordinate, they can sow the seeds of future reputational harm. For example, a marketing group may create unrealistic expectations for underwriting practices, leaving an insurer unable to meet customer expectations.

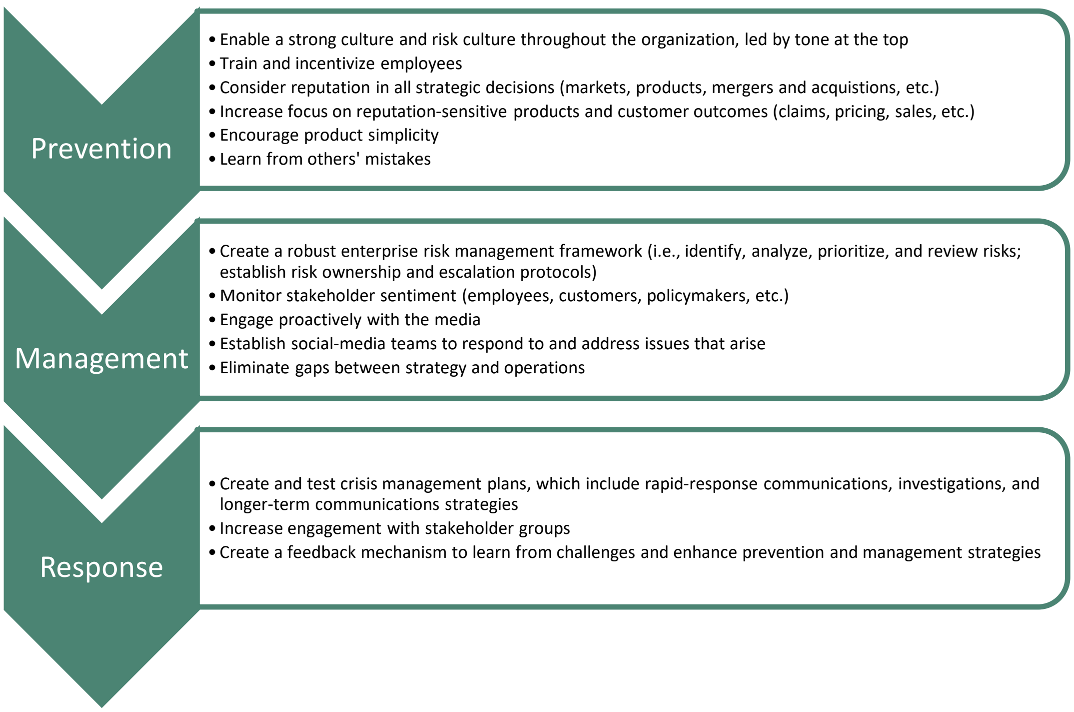
- **Clients.** Several participants mentioned that insurers could be affected by covering companies involved in reputationally damaging activities. One CRO noted, *"Swiss Re stopped reinsuring armaments companies. Others have said no to tar sands in Alberta. You have to think about how people will view your client list."* This kind of diligence is required not only to ensure avoidance of illicit activities, but also to steer clear of legal businesses that society regards unfavorably.

How can companies more effectively govern reputation and associated risks?

Reputation management is clearly the responsibility of the board, but participants differed as to the degree of board engagement and where the line should be between management and the board. During the calls leading up to the meeting and in the meeting itself, several high-level principles emerged. For further questions boards can ask regarding reputation management, see Appendix 2.

Sophisticated reputation management is a multilayer process

Reputation management and governance, like all risk management, demands prevention, management, and response. IGLN participants identified the following elements of effective management and governance of reputation.



While traditional risk management emphasizes prevention, several participants noted that reputation management should also emphasize appropriate response. One executive said, *"It is much harder to do the front-end work in reputational risk than in traditional risk management. You don't stop doing what you have been doing. You keep trying to do prevention, but you have to emphasize remediation and management."* In this regard, reputation management may be like cybersecurity management: companies should do the best they can to prevent problems, but accept and prepare for their occurrence. The fact that it can be difficult to prepare for the specifics of a reputation challenge makes it all the more important for insurers to be practiced and thoughtful in their response – otherwise they risk exacerbating the problem. *"We've all seen companies that say the wrong thing, or move too slowly or too quickly in responding to a crisis. You can make matters much, much worse,"* said one director.

Insurers should recognize the value in complaints

"We found out people who complain are very loyal … those that complain give us a touch point, an opportunity to pay attention to them. If we delivered when people complained, they paid us back in referrals. A trusted friend is very powerful," said one director. Several participants also agreed with one who said, *"The correlation between complaints and reputation issues is very high."* Complaints should be viewed as a leading indicator of possible reputational problems and an opportunity to improve a client relationship. *"If someone is complaining to a call center and we deal with it appropriately, it is a chance to build a relationship. We should view it as an opportunity,"* said one executive.

Companies should strive to treat customers the same, regardless of how they communicate with the company

Insurers should try to create a similar customer experience for complaints across platforms. One director said, *"We are schizophrenic. On social media we deal with customers quickly and on the phone we ignore them."* This kind of behavior fosters the belief among customers – young and old – that companies are not interested in service, and that customers must resort to threats or public shaming in order to receive assistance. Creating a comparable experience via different channels will encourage loyalty and decrease cynicism.

Insurers should evaluate executive compensation to ensure it does not encourage excessive risk taking

One director asked, *"Is the compensation scheme reasonable? Does it promote internal competition or results in ways that compromise values?"* One of the single largest sources of risk may be compensation schemes that do not align with the professed values of the firm, or that align with the goals of one unit or division, but not of the larger enterprise.

Boards should prioritize and regularly evaluate reputational risk

Participants identified several ways in which boards can add value with respect to reputational risk.

- **Explicitly link reputation to strategy discussions.** Reputation is tied directly to strategy, making it the purview of the board. *"With some risks, you can look at your risk appetite and dial something up or down. Reputation is different. You need to ensure it is part of strategy discussions. What are the reputational issues related to a certain product? Acquisition? Market?"* Directors widely agreed reputation should be a part of all strategic discussions, though some directors said that not all boards consistently evaluate strategy with reputation in mind.
- **Know and understand the factors that affect the firm's reputation and participate in decisions with reputational implications**. One director asked, *"When do you make the expensive decision because it is right for your reputation? Do those decisions take place at the board level? Is the board informed?"*
- **Prioritize reputation for executive management.** *"It is very easy to avoid hard questions until there is a problem,"* said one director. Because reputation is amorphous and defies quantification, companies tend to assign it a lower priority.

"If risk is its own culture, you already lost."

– Chief risk officer

"We all say reputation is our job," said one director, *"but what are we actually doing about it?"* Several directors suggested that as with other difficult-to-assess risks – cyber, culture, or conduct – reputation needs executive attention. One CEO suggested, *"The board needs to make it a priority for management, which is the best thing [the board] can do. [The board needs] to think about the policies they can set, including the tone at the top. They can make it a requirement for management to talk about it. They should look at what they are compensating me on."* One director said that if the board is to direct management, board members must take a more active role in understanding the risk: *"[I would] encourage all [non-executive directors] to get on social media to experience it, so that you don't just hear about it from other people. You don't have to do much, just observe."*

- **In a crisis, take responsibility and be both accountable and empathetic.** *"In many cases, you see the board abdicate responsibility. That always makes things worse,"* said one director. Furthermore, companies – including their boards – must be empathetic. One indicator of a healthy organizational culture is whether employees throughout the company can understand customers' experiences. *"You have to be authentic. If it comes from the culture of the company, you come across as authentic. The public is very perceptive. If the culture is all about hiding everything and then in a crisis you try to be transparent, it is not going to work."* said one director.

"Empathy is a product of the culture. It is not something you can turn on or off."
- Executive

- **Ensure crisis management is centralized, practiced, and tested.** Participants offered a lot of advice: *"You have to provide access to the CEO and chair,"* said one director. In a significant crisis, the chair and CEO will take the lead, and managing the crisis will become a full-time job. Another added, *"You can't overstate the importance of one message. All communications should flow through the designated people."* Another noted, *"If you don't know, say you don't know. Don't set it up so you have to retract something later."* Finally, one director warned, *"Never do anything prerecorded, or it will get edited and you might not like the result."* Participants acknowledged that under the stress of crisis, people, including leaders, make mistakes. *"People are people. In a real crisis they will have emotions. That is part of why you have a plan ahead of time and you practice it."* Another director noted, *"You can't mitigate all risk, but you can control the speed of your response."* Having a centralized and practiced approach, with a clear and consistent message, will help minimize error.

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For insurers to reap the full benefits of a good reputation, they must actively build it, manage it, and achieve resiliency in the face of adverse events. Internal programs and compliance functions such as those intended to improve cybersecurity governance, increase claims transparency, or simplify communications play a significant role in mitigation when crises arise. Increasingly, boards also have a role in managing reputation through strategic oversight of risk, prioritization of resources, and crisis response. One director emphasized the reason for all this effort: *"I believe there will be more and more opportunities to* *practice crisis plans. We think we have a strong reputation, but I think we'll see more reputation emergencies."* The conversation in New York scratched the surface of reputation management. We hope that it provides useful insight for directors as they think about this challenging aspect of the governance of leading insurers.

About the Insurance Governance Leadership Network (IGLN)

The IGLN addresses key issues facing complex global insurers. Its primary focus is the non-executive director, but it also engages members of senior management, policymakers, supervisors, and other key stakeholders committed to outstanding governance and supervision in support of building strong, enduring, and trustworthy insurance institutions. The IGLN is organized and led by Tapestry Networks, with the support of EY. *ViewPoints* is produced by Tapestry Networks and aims to capture the essence of the IGLN discussion and associated research. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of senior management, advisers, and stakeholders who become engaged in this leading edge dialogue, the more value will be created for all.

About Tapestry Networks

Tapestry Networks is a privately held professional services firm. Its mission is to advance society's ability to govern and lead across the borders of sector, geography, and constituency. To do this, Tapestry forms multistakeholder collaborations that embrace the public and private sector, as well as civil society. The participants in these initiatives are leaders drawn from key stakeholder organizations who realize the status quo is neither desirable nor sustainable and are seeking a goal that transcends their own interests and benefits everyone. Tapestry has used this approach to address critical and complex challenges in corporate governance, financial services, and healthcare.

About EY

EY is a global leader in assurance, tax, transaction, and advisory services to the insurance industry. The insights and quality services it delivers help build trust and confidence in the capital markets and in economies the world over. EY develops outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, EY plays a critical role in building a better working world for its people, for its clients, and for its communities. EY supports the IGLN as part of its continuing commitment to board effectiveness and good governance in the financial services sector.

Appendix 1: Meeting participants

AIG

- Steve Miller, Non-executive Chairman of the Board
- Doug Steenland, Regulatory, Compliance, and Public Policy Committee Chair and Risk and Capital Committee Member

Aon

- Mike Losh, Audit Committee Chair

Federal Reserve (New York)

- Lauren Hargraves, Senior Vice President and Senior Supervisory Officer, Financial Institution Supervision Group
- Vandana Sharma, Vice President, Financial Institution Supervision Group

MetLife

- Frank Cassandra, Senior Vice President, Global Risk Management

Nationwide Building Society

- Tim Tookey, Risk Committee Chair

Prudential Financial

- Nicholas Silitch, Senior Vice President and Chief Risk Officer

QBE Insurance Group Limited

- John Green, Deputy Chairman

Sompo Japan Nipponkoa

- Jan Carendi, Senior Adviser to CEO

State Farm

- Ed Rust, Chairman

USAA

- Eileen Collins, Vice Chair, Risk Committee
- Van VanAntwerp, Member, Risk Committee

Zurich

- Joan Amble, Audit Committee Member

EY

- Tom Campanile, Partner, Risk Governance Lead, Financial Services Risk Management
- Shaun Crawford, Global Insurance Sector Leader
- Rick Marx, Principal, Business Advisory and Risk Management Services, Insurance

Tapestry Networks

- Leah Daly, Principal
- Jonathan Day, Vice Chairman
- Colin Erhardt, Associate
- Peter Fisher, Partner

Appendix 2: Reputation management questions for boards

In thinking about reputation and its risks, directors may wish to consider the following questions:

- Is management focused sufficiently on guarding the insurer's reputation? Are risks to reputation considered material risks?
- How is reputation actively managed throughout the organization (on the front line, by middle management, and at the executive and board level)? Is reputation a part of strategic discussions?
- What is the board's role in governing reputation?
- Does the organization regularly identify reputational threats and develop response plans or deploy solutions?
- How is the board informed of changes in risk profile or other possible reputational risk triggers?
- How do existing crisis management plans define expectations for board members?
- What reputation-related challenges and opportunities exist in the insurance sector as a whole?

Endnotes

[1] *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of network participants and their corporate or institutional affiliations are a matter of public record, but comments are not attributed to individuals, corporations, or institutions. Network participants' comments appear in italics.

[2] Aon, *Global Risk Management Survey 2015* (London: Aon, 2015).