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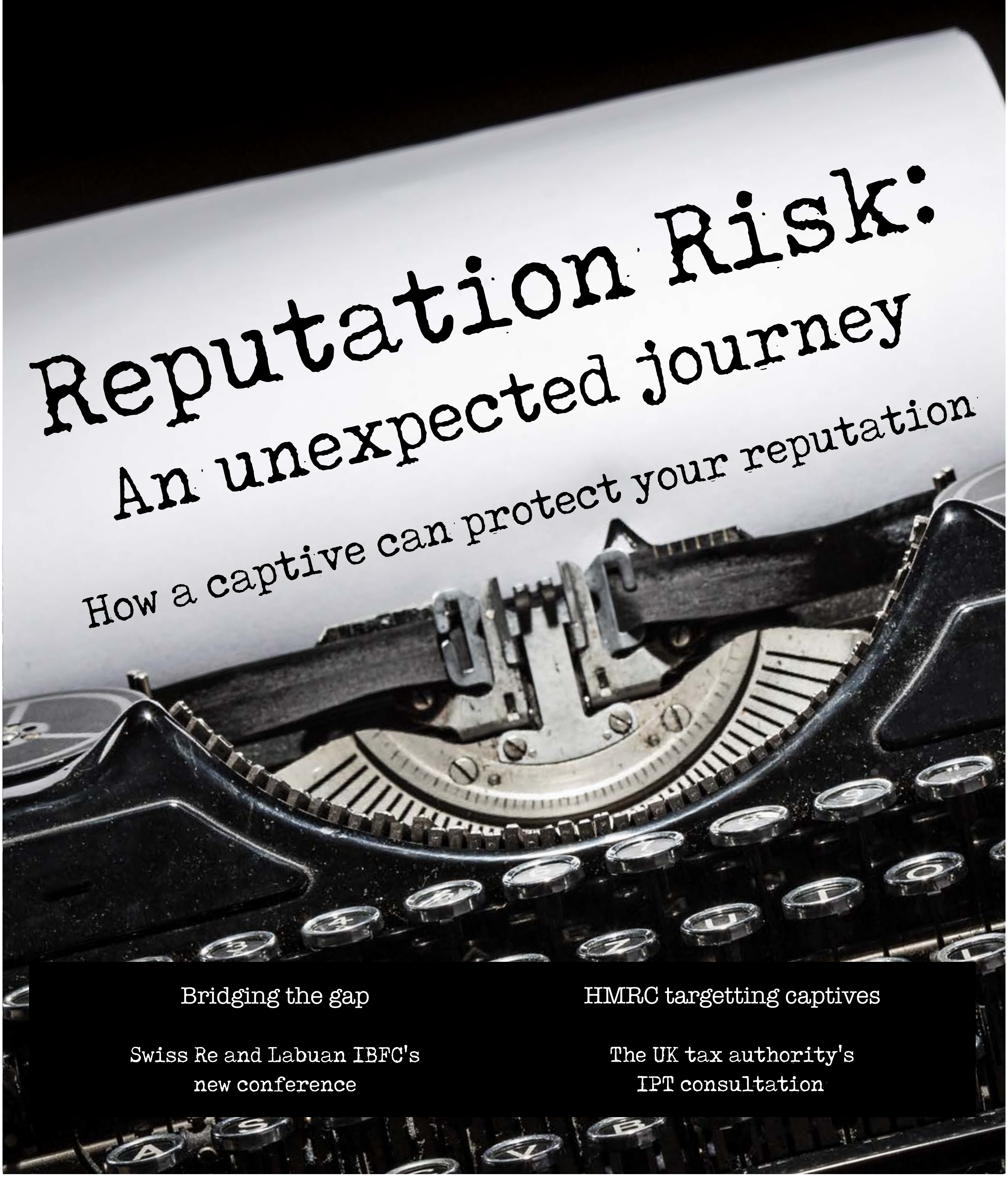


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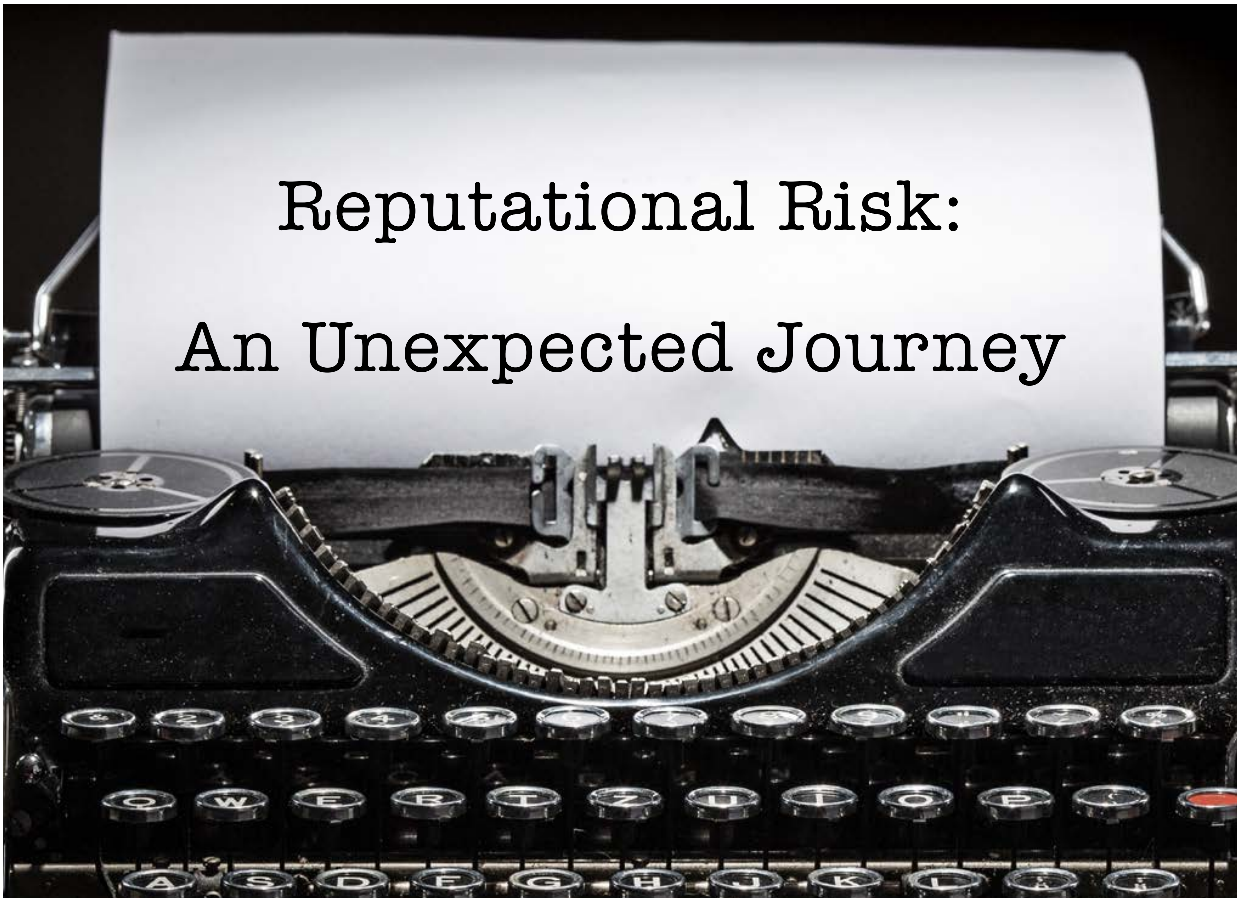


# Reputational Risk: An Unexpected Journey

Reputational risk has historically been seen as a marketing issue, but Nir Kossovsky of Steel City Re explains how insurance and, more specifically, captives, can be used to tackle the risk to your reputation

When you think of a company's reputation, it might strike you as a marketing topic, certainly not something for your risk department to look at. Yet, in recent years, the risk of a reputation loss and its potentially financially damaging effects has driven companies and brands to refocus their efforts into looking at reputation risk as an insurable interest.

Nir Kossovsky, CEO of Steel City Re, a reputation risk management company offering robust risk management solutions for both a company and its board, says captives are "key" to the reputation risk financing effort.

## An unexpected party

Steel City Re entered the insurance markets by first providing pricing underwriting support to captives, and later by reinsuring such risks through the more traditional risk transfer markets.

"A captive can create huge value for a company, just by having the capital reserve to let the credit markets know that, even if there is a short term temporary shortfall, the cash flows (which might arise from customers backing off or rapid employee turnover) will not be materially affected." Kossovsky observes.

"A captive can actually protect the cost of capital to a firm and provide a measurable return on investment on the avoidance of an increased cost of capital."

Reputation is based on a stakeholders' expectations of a company's real-world performance, an expression of what stakeholders value in a company's quality, ethics, safety, security, innovation and sustainability.

Reputational risk can therefore be defined as the peril posed by a company's potential failure to meet those expectations, often because they do not align with a company's real-world capabilities.

Reputational crises occur when stakeholders become aware of the differences between their expectations and reality. This could then translate into material, economic or political losses.

But Kossovsky says reputational risk is still misunderstood by many companies.

According to Kossovsky, narrow thinking on this topic has existed for nearly 20 years, even as boards have been prioritising surveys on the importance of reputation to their businesses.

Businesses have also been disclosing both the value of corporate reputation and the materiality of risks to reputation with regulatory filings, but Kossovsky says that, until now, their solution has been to task marketing and communications departments with reputation risk management.

Some even deploy different social programme strategies, such as corporate responsibility and environmental, social and governance responsibilities, in lieu of more traditional risk management strategies, such as insurance.

What companies are discovering now, and where Kossovsky believes there is a massive opportunity for captives, is that reputation is more an issue for the risk side of the house than for the marketing side.

That's not to say that firms haven't been insuring against reputational losses.

According to Kossovsky, some companies have been using captives for this for decades. Steel City Re has provided underwriting support for around 300 of these.

He adds: "Most companies have historically treated reputational risk and crises as conversation topics, or 'acts of God' similar to 19th century company outlooks on lethal steam boiler explosions. As most insurance professionals know, our industry helped put a stop to that string of crises with better engineering backed by insurances."

"The same holds for reputation risk today. Financing reputation risk through captives, along with better governance engineering, represents a terrific opportunity for captives to provide huge benefits to their parent, as well as a significant opportunity for captives to improve their overall financial performance."

Kossovsky reflects: "In simple economic terms, financing reputation risk is a strategy through which companies can help insure their intangible assets, which today on average are four times more valuable than the tangible (property) assets that most companies typically insure."

Kossovsky jokes that some firms would have a better time with their reputational risk if their stakeholders expected nothing from them.

He adds: "The intensity of reputational damage and potential losses are a result of how strong the emotional connections are and the degree to which stakeholders are angered."

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Nir Kossovsky, CEO of Steel City Re

## Out of the fying-pan into the fire

As the world has transitioned online and the world of reputation risk has enlarged, a number of areas have emerged with traps and pitfalls for reputation.

Kossovsky describes reputational risk as a “three-legged peril”: there must be an expectation, that expectation must not be met, and that causes disappointment.

The degree of this disappointment has to be sufficient enough to evoke an emotional response, because that is what drives the damaging economic and political behaviours.

Kossovsky points to boycotts, resignations and internal litigation as some of the damaging behaviours the public may have been made aware of in recent years.

In the digital world, social media can be an “incredible amplifier for emotion”, Kossovsky says.

“The psychology of social media is ‘we share because we care’.”

“The more somebody cares about an issue, the more likely they are to share it on social media,” he adds,“one can have an expectation or disappointment by both direct and indirect experiences”.

Social media has expanded the range of potential stakeholders who may become disappointed and exercise their economic power in anger. With quicker and wider broadcasting of potential issues, more of the population is effected, leading to greater backlash.

**If the owners’ behaviours end up being disappointing through ethical or safety issues, it is not certain that these firms could recover”**

“Even regulators—human beings with emotions— have the freedom to apply the law or give the company a break, so the intensity of emotion is an important driver of reputational damage, and why crisis communications professionals believe apologies are so important.”

In this sense, captives are a great help due to their increased capital reserves capacity and better preemptive storytelling as part of a reputation risk management strategy, Kossovsky notes.

“The roles that captives play is, in part, setting the expectations of the capital markets by providing reserves to cover the shortfall in the even that something bad happens,” he observes, “it’s a very important signal to be sending out”.

## Fire and water

One might imagine that a reputational risk management strategy would be confined to large businesses with full marketing departments, but Kossovsky says that a reasonable fraction of Steel City Re’s captives are actually smaller, privately-held firms who are well known in their community.

The expectations of these locally owned businesses are “very high” and the value of these firms are tied to stakeholders’ expectations of the owners.

Kossvsky says: “If the owners’ behaviours end up being disappointing through ethical or safety issues, it is not certain that these firms could recover.”

And Kossovsky argues that reputational risks need to be understood by businesses from day one.

He adds: “Adverse reputations can be a body blow to any company, particularly those that do not have the resilience to withstand that loss.”

Even when alleged misbehaviours are not truthful, just allegations may be sufficient to tarnish the reputation of a firm that has not yet built up its resilience.

In any case, captives are key to a reputational risk strategy, from its increased capital reserves, to the story a captive tells in managing your reputation.

Kossovsky says that being able to tell stakeholders that your business understands the real world of behavioural economics at a governance level through systems, oversight and risk management is how you both create your reputational value and protect it in the event of potential disappointment. ■