2018 CLM & Business Insurance Retail Restaurant & Hospitality Conference

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Buckle Up. Emerging Risks Ahead

I. The What

Understanding Emerging Risks

The current landscape of the Retail, Restaurant and Hospitality business is in a constant state of change and growth. With these changes come new and unchartered risks and exposures. These emerging risks are of concern to the Retail, Restaurant and Hospitality risk manager, general counsel and claims professional. The concept of emerging risk has gained increasing attention in recent years. But what is an emerging risk? Various well respected institutions define emerging risks as:
Lloyds of London: An issue that is perceived to be potentially significant but which may not be fully understood or allowed for in insurance terms and conditions, pricing, reserving or capital setting.
Price Waterhouse Cooper (PWC): Those large scale events or circumstances beyond one's direct capacity to control, that impact in ways difficult to imagine today. Standard and Poors (S&P): Risks that do not currently exist. The International Risk Governance Council (IRGC): A risk that is new, or a familiar risk that becomes apparent in new or unfamiliar conditions.

These are risks that in the service industries are increasingly being exposed to and the majority of risks which fall out of the range of traditional risk and claims management. Therefore the need to provide awareness about what the risks are and how to identify them.

Common Characteristics of Emerging Risks

Certain commonalities and traits accompany these emerging risks for the Retail, Restaurant and Hospitality entities. Some of these common traits and characteristics include but are not limited to:

- High degree of uncertainty
- Difficult to quantify, analyse, categorize and more so to predict
- Are human, economic, natural or combination
- Limited industry position or response plan in place
- Regulatory involvement or lack of involvement can have an affect
- Local and/or global

Woven within these overarching traits are outside influencers that each emerging risk has attached to it. These may positively or negatively impact the emerging risk. Economics, politics, regulation, technology, legal environment, Catastrophic (CAT) events, demographics, or culture are the main drivers when assessing the emerging risk for the claims or defense attorney of a Retail, Restaurant and Hospitality company.

II. Black Swan Events

Black Swan as part of Emerging Risks

Often cited as unusual or different than what is imagined in most of nature is a black swan (the exceptions include New Zealand and parts of Australia). These are rare creatures as are emerging and unpredictable risks. In risk management, “a black swan event” is an unpredictable, rare, but nevertheless high-impact event. The concept was brought to the insurance world’s attention and to risk and claims personnel by Nassim Nicholas Taleb in his book of the same name. While most companies and their risk managers and attorneys are happy with thinking about what they *do* know, Taleb focuses on what they *don't* know. He believes this is far more relevant to responding and defending these type of events. Unpredictable events by their very nature are things that lie outside a common experience and happen precisely because of this. Complacency and acceptance of what is normal becomes the exact reason why companies are unprepared for black swan events. Therefore a good appreciation of a company’s own ignorance and a full rationalization of where their risk knowledge ends is essential in dealing with although not necessarily able to avoid black swan events.

Black Swan Characteristics

A black swan event has three properties that make it so. Just as an emerging risk has traits and characteristics. For the black swan event all three should be present. They include, rarity, extreme impact and retrospective predictability.

Rarity: The black swan is a rare event. It is outside the realm of common experience and nothing in past experience(s) points to its possibility. A black swan is that million-to-one chance that statisticians or actuaries predict would never happen because it was a million-to-one chance. Of course, million-to-one chances do happen.

Extreme Impact: When the black swan strikes, it has a massive impact. Examples may be two of the world's tallest buildings being destroyed, a gunman opening fire at a concert killing, a tsunami or earthquake over a major city or country, the loss of a major court case. Not only is the qualitative nature of the black swan event outside the systematic experience (translation---companies did not see it coming), the event or emerging unseen risk has a quantitative nature as to its sheer size, in that a single event can dominate over all other factors.

Finally, the third element is Retrospective Predictability: This characteristic explains the concept of "black swan blindness" or "black swan denial". It is the illusion that risk managers and claims professionals can actually see things coming. Predicting the future. This stems from a false narrative to construct a workable story using only the pertinent information of the past that had no value for the future. In reality this approach makes companies more vulnerable. The example used is of a turkey being raised solely for a holiday dinner. From past events, the turkey considers itself the luckiest bird in the land. It is fed and watered every day and generally kept happy. There is absolutely no indication from these past actions that suggest one day it might be slaughtered for the family festive meal. However, after this event, if the turkey lives to figure all this out, it becomes "recognizable and obvious" that it was being raised for slaughter. All of the protection, soft music, quiet lighting, and vaccinations are to keep it healthy and the excess food is to fatten it up. Like companies who experience a black swan event, the narrative becomes clear AFTER the event.

The three fundamentals in a black swan many times interconnect with an emerging risk or exposure as to the impact (human, economic, financial) and the unpredictability along with the rareness of the emerging risk or event. Companies operating in the Retail, Restaurant and Hospitality space routinely do not plan for Black Swan events nor have the ability to defend against them if litigation arises from the event.

III. What Are the Emerging Risks In Retail, Restaurant and Hospitality?

Classification of Emerging Risks in the Industries

Guy Scott, CEO of Econorisk and former CEO of Aon Risk Services in South Africa, stated. "Apart from the 'traditional' types of risks, such as natural disasters, threats of power failures and the risk of non-delivery by outsourced partners - which all have a direct effect on customer service, food and beverage operations and safety - hotel owners and managers need to ensure that they are aware of any emerging or overlooked risks in the industry by continuously re-evaluating their risk management strategies." For Retail, Restaurant and Hospitality risk and claims professionals there is a need as Scott attested to not forget the “mundane risks” but to continuously reevaluate existing and future risks. This needs to start the emerging risk evaluation process via identification and risk awareness so that the emerging risks are measureable and prioritized.

Many Retail, Restaurant and Hospitality companies however, rely too heavily on insurance for their traditional risks and fully expect that insurance to cover their emerging risks as well. In many cases it does not. Therefore the searching for and categorizing of emerging risks is critical. The emerging risks fall into one of 5 classes. The classes are Human, Economic, Natural, Technological or a Combination. Each has a unique and distinct definition that management has to calculate when evaluating the emerging risks. The task of clustering involves recognizing inherent structure in the emerging risk data set and grouping risks together by similarity into these classes. The technology class is the fastest growing class for the Retail, Restaurant and Hospitality businesses.

Emerging Risks

In the last several years, the Retail, Restaurant and Hospitality sectors have faced significant challenges as a result of the economic and market competition, consumer purchasing changes, artificial intelligence, robotics and technology, as well as global political uncertainty. Against this background, Retail, Restaurant and Hospitality operators continue to face risks associated with the traditional business operating model, such as risks associated with property, casualty, employee and customer safety and net income. New and or developing risks such as the following are only a part of the list of emerging risks:

Workplace Violence including the 3Ds of workplace violence (delusional, disgruntled, domestic), terrorism (domestic and international), active shooter and open carry (prevention and protocols);

Autonomous Modes & AI including automobiles and vans (delivery, passenger transport, valet), drones (delivery, recreational rental and security), robotics (warehouses, equipment, virtual (clerks, front desk, wait staff);

Market Technology including wearable technology (safety, tracking and security). human implant chips, RFIDs (restaurant pager, hospitality/entertainment, retail payment);

Payment systems including Bitcoin (acceptance and usage), blockchain (development and growth), compliance (Payment Card Industry Data Security Standard, SDP, GDPR and AIS);

NLRB including franchisee/subcontractor (*Browning-Ferris Industries*, 362 NLRB No. 186…Aug. 27, 2015 and McDonald's);

Environmental including Legionella (new requirements), meth labs (hospitality specific), mold (after a CAT and in restaurant growth), silica;

Social Media including website risks (statements, warranties, and privacy), apps (technology changes, copyright, instore tracking, privacy and instant offerings), reviews and ratings (yelp, urban spoon, instant response with manager), data mining;

Pandemic including Ebola, Zika, influenza, E-Coli, listeria (prevention, coverage, Claims

Reputation & Crisis Management including who is your spokesperson?, where the hits come from (media, class action, shareholder, employees)

Retail, Restaurant and Hospitality legal, claims and risk professionals have to calculate the importance of these and other emerging risks interconnected to their company's risk tolerance corridor. These professionals have to understand what the company will accept from an exposure standpoint related to the new and rising risks. They will have to make an assessment of the potential financial impact, taking into account potential correlation with other risks already present in this customer oriented industry.

For a company, the degree of response and awareness of the emerging risks that they are facing have to be taken into consideration. The emerging risk could be considered to be very low frequency/high intensity indicators, but if exposure to that particular risk is limited, then the impact on the company may not be as important. On the other hand, unforeseen risk correlations cannot be underestimated. Even small emerging risk exposures can merge into a punishing high risk if core risks are interdependent. When developing extreme "what if" scenarios, a healthy dose of awareness and of imagination to think of unthinkable emerging risks is always beneficial.