ZURICH®
MUNICIPAL

RISK AND RESPONSE

THE EMERGING DYNAMICS OF MAJOR INCIDENTS IN THE **SOCIAL HOUSING SECTOR**

IN ASSOCIATION WITH

Ipsos MORI

CONTENTS

For further information, please visit:
www.NewWorldofRisk.com

FOREWORD

Richard Wood
Head of Housing

At present, the social housing sector remains in flux. In conditions of austerity the sector has found that its traditional funding mechanisms are continuing to be put under pressure. Government grants continue to be cut, and the Government's ambitious programme of welfare reform will see changes that will significantly change the way rent costs are collected from tenants. Moreover, providers who chose to borrow on capital markets will find this harder as financial markets remain volatile from Eurozone fluctuations. Due to these pressures, social housing providers are finding that their income streams are becoming increasingly less secure at a time when demand for social housing continues to far outstrip supply. As a result, social housing providers are now more exposed to wider risks and their ability to provide effective services and respond to major incidents needs to reflect this.

As a major insurer of the public sector, we recognise the importance of constantly reviewing the range of guidance and solutions we offer in order to make sure they reflect emerging risks and new ways of working. Building open and productive relationships with social housing providers has provided us with a unique insight into the challenges the sector faces when dealing with major incidents.

This report, developed in association with Ipsos MORI, looks at how these risks have continued to develop, and builds on our initial audit of the sector that we put together in 2010. When compiling this report we spoke to Chief Executives and senior managers across the social housing sector to ask what risks they foresee for their organisations in the next few years, and how well prepared they believe their organisations are to cope with them. We have compared results with the views of our own experts at Zurich Municipal.

Our view is that social housing providers need to have a clear understanding of what risks affect their organisations to ensure they build resilience to deal with potential major incidents, such as supply chain risks, governance failures and major fires and explosions. We believe that this report will be of lasting benefit and will help the sector identify where more work needs to be done.

PERSPECTIVES ON MAJOR INCIDENT RISK

THE LANDSCAPE

WELFARE REFORMS, GROWING DEMAND AND FINANCIAL PRESSURES ARE CREATING AN ENVIRONMENT IN WHICH REGISTERED PROVIDERS (RPs) MAY FIND IT MORE DIFFICULT TO PREVENT, MANAGE AND RECOVER FROM MAJOR INCIDENTS.

On 8 March 2012 the Welfare Reform Act 2012[1] received Royal Assent. The Act introduces a wide range of reforms aimed at making the benefits and tax credits system fairer and simpler. However, the new regime, due to be phased in during 2013, may have adverse effects for RPs.

Key among the changes is the introduction of the Universal Credit system where a single monthly payment to claimants replaces a range of individual working-age benefits. This means that support with housing costs will go direct to claimants as part of their monthly payment, instead of RPs receiving income direct from the Government.

As a result, RPs will be responsible for collecting rent directly from tenants. This is likely to increase their administrative burden with a knock-on effect on costs. It will also have an impact on their tenants, for many of whom managing money is a very real concern.

In a written submission from the New Charter Housing Trust to Parliament in June 2011[2], the Trust said that a survey showed that 27% of tenants have some long term debt and 53% have money worries. It warned that non-payment of rent by only 4% of its tenants currently having their housing benefit paid direct to the landlord would compromise its business plan, and therefore its service delivery.

The Trust also considered that reduction in housing benefit for under-occupancy would compound the issues for tenants who currently struggle to manage their budget. It is anticipated that tenants who under-occupy their home would have to make additional rent payments of between £11 and £25 per week. "We have analysed the impact and in summary, it is expected that our tenants will have to find in the region of £628,000 per annum to cover the reduction in housing benefit on this issue alone" it said.

The Department for Work and Pensions (DWP) anticipates that most people will be relatively sophisticated in terms of applying online and managing their claim through an online account. The initial intention was to pay the Universal Credit into claimants' bank accounts. However, recognising that not everyone has a bank account, the DWP has now signed a seven year deal with Citibank working in partnership with Paypoint to set up a new Simple Payment service that will allow people to access their benefit money at paypoints[3].

In addition to the regulatory changes embodied in the new welfare reforms, RPs face additional challenges in the current environment.

GROWING DEMAND AND POTENTIAL SHORTFALL

A May 2012 report from the Communities and Local Government Committee[4] predicts a significant housing shortfall, amplified by the financial crisis "with 232,000 new households forming each year in England. Last year fewer than 110,000 new homes were completed".

Demographic issues are also likely to have an impact on social housing demand. The ageing population, high youth unemployment and relatively high house prices all increase the potential for greater demand for social housing, putting pressure on providers to increase supply.

Build Now or Pay Later?[5], an October 2011 report from the Institute for Public Policy Research (IPPR), predicts there will be four million additional households in England by 2025 as a result of population growth (for example, through immigration), demographic change (such as an ageing population) and social change (for example, an increasing divorce rate). It expects to see the worst mismatches between supply and demand in the Greater South East, with particular pressure on social housing.

CONTINUING FINANCIAL PRESSURES

RPs are competing for lender finance at a time when the financial markets remain volatile, with any significant new downturn likely also to affect contractors and the way that investors view the prospects for the housing sector.

The need to conserve capital could result in reduced spending on maintenance, improvement and risk management, as well as diminishing the resources that suppliers and partners can apply to outsourced services. The latter is particularly crucial in view of RPs' increased use of outsourcing as a means of cutting their internal costs.

GOVERNANCE CHANGES

Legislative and regulatory changes are placing new demands on RPs. For example, in England, RPs have to provide assurance to the regulator on how they are managing their risks which may involve dedicating more time and management capacity as well as possibly extending existing skill sets.

Failure to demonstrate best practice may result in regulatory intervention, financial penalties (for example associated with breach of data security laws), reputational damage and difficulty in accessing funding.

KEY POTENTIAL MAJOR INCIDENT CAUSES

Zurich Municipal defines a major incident as 'a significant event which demands a response beyond the routine. The event may result in significant service disruption, large scale financial or operational repercussions, reputational damage or physical harm to staff, residents or service users within the community.'

With this definition in mind, and based on research with social housing leaders, risk experts and our own expertise, Zurich Municipal believes that these emerging challenges will affect major incident risk in three particular areas over the next few years:

- Supply chain failure
- Major fire/explosion
- Governance failure

While RPs may have put processes in place to respond to major incidents in these areas, we believe that they may need to increase their focus on long-term recovery following such incidents.

RISKS FACING THE SECTOR

MOST HOUSING LEADERS THINK THAT THEIR CHANCES OF HAVING TO DEAL WITH A MAJOR INCIDENT WILL INCREASE OVER THE NEXT THREE YEARS, ALTHOUGH MANY ALSO CONSIDER THE LIKELIHOOD WILL REMAIN THE SAME.

The changing financial and policy context in which RPs operate is a cause of concern for many housing leaders. In the research they raise the impact of the downturn in the financial markets and the continuing effects of public sector cuts as key challenges.

Almost all leaders see decreased funding as a factor likely to increase the chances of a major incident happening in the housing sector, followed by the impact of rising demand for services.

The potential impact of welfare benefit reform has caused uncertainty and made it more difficult to plan financially, with some housing leaders anticipating possible reductions in rental income. Some are concerned about changes to payments being made by customers rather than local authorities – this may have a negative impact on their cash flow and therefore financial resilience.

"WELFARE REFORM AND THE POTENTIAL LOSS OF RENTAL INCOME IS AN AREA OF UNCERTAINTY FOR US."

Housing Leader

One of the most prominent major incident risk areas to emerge from the research is health and safety relating to utilities. For instance gas explosions are mentioned, with one housing leader pointing out that this could arise because of non-maintenance of the gas supply. Indeed, housing leaders discuss a range of traditional major incidents (including flood, fire and serious accidents) which would require tenants to be rehoused.

From the specific risk areas that were discussed with respondents, organisational change and cyber security are seen as the most likely to happen. Housing leaders also highlight changes to tender processes and the value of contracts as a result of efficiency drives. One housing leader notes that they have now moved to shorter contracts, with less support for users within those contracts. As a result there are both fewer resources and less flexibility to shift resources around than was the case with block contracts.

"PEOPLE HAVE BEEN FORCING PRICES DOWN AND IT COULD INCREASE THE LIKELIHOOD OF A MAJOR RISK OCCURRING"

Housing Leader

Relationships with suppliers are raised by some housing leaders. Some are confident about how they were managing these on a day to day basis, pointing out that they had arrangements in place to cover eventualities such as holidays. Others take a broader outlook, expressing concern about the effect of financial pressures on suppliers' solvency.

Another concern for housing leaders is any major incident which leads to loss of life in a residential property. If the blame for this can be laid at their door, then the reputational damage is much more severe. One housing leader says that if a death occurred as a result of the actions of an employee, their business probably would not continue as they would not be commissioned in the future.

"WE ARE VERY TIGHTLY REGULATED SO OUR BUILDINGS ARE UP TO SCRATCH."

Housing Leader

ADDITIONAL RISKS

In addition to the three major incident risk areas that we focus on in this report, there are other risk areas that were mentioned by our research respondents that have the potential to cause significant losses.

Severe weather events can affect tenants, RPs' staff and maintenance crews. For example, one RP had to close its head office for several days in 2012 because of severe flooding[6]. Multiple premises can also be affected in the same location, if the flooding is significant.

Diminishing community cohesion is increasing the likelihood of vandalism and tenant rent strikes, in addition to civil disturbance and riots as experienced in 2011[7]. These have the largest impact in metropolitan areas with damage to residential property as well as commercial premises.

Failure of IT systems could potentially cause severe disruption for RPs, particularly when welfare reform means that they are relying upon systems to manage rent collection. Efficient back-up is essential. It should be a key part of providers' overall business continuity plans and not just part of an IT disaster recovery plan.

Loss of critical infrastructure could result from a variety of occurrences including severe weather, physical hazards such as fire or explosion, or IT telecoms system failure. Losing a contact centre or even the main operations base would deny access to staff, tenants and visitors, as well as use of IT and telephone systems and crucial files.

Reputational damage can result from failing to manage key risks. The Homes and Communities Agency's viability and planning tools[10] cover a range of areas including best practice and viability planning and may identify any such failings. Credit rating agencies also assess and grade some RPs' ability to meet their debt obligations. Thus reputational damage can have a direct adverse bearing on the amount of funding that RPs can attract to develop their services and pursue their business plans.

Cyber risks such as data loss and system hacking are regarded by research respondents as relatively likely to happen. The risk that these may escalate into a costly incident is increasing, and the research shows that housing leaders are generally less confident regarding their ability to respond compared to other risks.

- Welfare reform will require RPs[8] to manage a larger amount of sensitive data (for example tenants' bank account details) which means that they are more likely to become a target for hackers.

- The Information Commissioner's Office (ICO) has already investigated several data breaches by RPs. So far it has been content with formal undertakings from those concerned that there will be no recurrence. However, the ICO now appears to be taking a tougher stance on public sector organisations, for example imposing a civil monetary penalty (CMP) of £325,000 (a record penalty at the time) on an NHS trust in June 2012 following a serious breach of the Data Protection Act[9].

- Regulation on data protection is increasing with the European Commission proposals in January 2012 of a comprehensive reform to the EU's 1995 data protection rules. These include potentially greater penalties for personal data breach.

- RPs that outsource data management may also be held accountable for any data breach by their supplier.

KEY MAJOR INCIDENT RISK CHALLENGES*

SOCIAL HOUSING LEADERS' VIEW	ZURICH MUNICIPAL'S VIEW
Utility failures/issues	**Major financial crisis**
Financial/funding reduction	**Fire/explosion**
Fire/flood	**Supply chain failure**
Cyber risks	**Governance failure**
Changes to welfare policy	**Severe reputational damage**

*The key risk challenges cited above are not ranked on a relative basis

Whilst financial pressures represent a major risk, to a significant extent their likelihood is dictated by national economic considerations rather than the individual RP's management. In selecting its major incident risk challenges, Zurich Municipal has focused on those areas where individual RPs have greater control and where their actions can not only help to prevent or mitigate major incidents but can also have considerable impact on their ability to recover.

EMERGING AREAS OF CONCERN

SUPPLY CHAIN FAILURE

INTERDEPENDENCY IN THE SOCIAL HOUSING SECTOR IS INCREASING. MOST RPs DEPEND TO SOME EXTENT ON EXTERNAL SUPPLIERS AND PARTNERS. THESE COVER A WIDE RANGE OF BOTH FRONT AND BACK OFFICE ACTIVITIES. IN ADDITION TO CONTRACTORS, THEY INCLUDE LOCAL AUTHORITIES, CHARITIES, I.T. PROVIDERS AND OTHERS – IN ESSENCE, ANY PARTY THAT RPs RELY UPON TO DELIVER SERVICES DIRECTLY TO THEMSELVES OR JOINTLY OR ON THEIR BEHALF TO TENANTS.

A poll of delegates at the National Housing Federation (NHF) conference in March 2012 showed that almost three-quarters of respondents considered supply chain failure to be a key priority. The potential severity of this risk is such that the NHF provides online guidelines on supply chain self-assessment[11].

The potential for supply chain failure to evolve into a major incident is exacerbated by the fact that there is rarely just one organisation in the supply chain. While it may be possible to spread the risk by using two or more organisations or partners to provide similar services, this may be less cost effective than a sole supplier agreement. Using multiple suppliers also involves ensuring matching service delivery standards.

Further, the aim of 'spreading the risk' may be futile if, behind two or more separate suppliers or partners, is a single supplier to all of them and a problem occurs within that organisation. Failure of suppliers in the second, third or even fourth tier of the supply chain can have a domino effect that reverberates throughout the entire chain. The Business Continuity Institute survey, *Supply Chain Resilience 2011*, sponsored by Zurich, shows that, while 61% of disruption originated with tier one suppliers, 30% was at tier two and nine per cent at tier three or lower[12].

It can take a long time to recover from the disruption caused by supplier failure, particularly if RPs do not have in-house ability to deliver the affected services or the money available to pay high quality alternative suppliers. This was certainly the case with the failure of contractor Rok in 2010 when some clients had to find alternative firms to complete projects. There is also the danger of non-availability of alternative suppliers, perhaps because they are already fully committed to other clients.

A November 2011 article in Construction News, *One year on: The impact of Rok's demise*, says the Rok failure following that of Connaught, increased focus on protecting maintenance services. Strategies include dividing contracts between smaller, more local players, taking services back in-house and greater analysis of contractors' financial standing[13].

Local authorities that outsource social housing should also be aware of potential supply chain issues. For example, those that relied on Darlington-based Southern Cross to provide social care home places[14] faced problems in 2011 when the business failed. At the time, it was operating nine per cent of all care home places and homes had to be passed to new owners to ensure continuity for existing residents. This also becomes an issue for RPs if they diversify into the care sector.

Outsourcing by local authorities and RPs to external suppliers and partners can be expected to increase as it can be an effective model for containing or reducing costs. For example, with the new Welfare Reform Act requirements, some RPs may consider outsourcing rent collection. They may also seek to improve back office efficiency by outsourcing business processes on an individual or group basis, either using an external provider or an internal support function serving the group.

However, we believe that it is essential that the commissioning organisation considers the long-term viability of supply chain arrangements. Supplier failure can transform short-term gains into a long-term loss. Understanding the supply chain and, in particular, the crucial 'links' where breakage could result in a major incident is vital. Ensuring that an appropriate contract is in place with all partners such as organisations within the third sector is critical.

For example, identifying capacity and appetite within the construction market is important in assessing contractors and achieving appropriate, realistic quotations. This is directly linked to other areas of activity such as developer or lender failure. Another major banking crisis could put extreme pressure on contractors. In addition, as with all key suppliers, it is advisable to identify potential alternatives that may be available at short notice to step in should a problem occur.

Failure of a key supplier, particularly one used by a number of RPs, can mean that alternative suppliers are able to increase their prices in a market of reduced competition. Further, an RP may lose its priority position when moving to an alternative which can have an effect on the service provided, i.e. if that alternative then has a problem in service delivery, it is likely to give priority to pre-existing or larger clients.

All of these issues can make the difference between successfully completed projects or service delivery and a costly contractor/service failure.

The double dip recession and consequent current financial constraints are putting pressure not just on RPs but also on their suppliers. If these suppliers are exposed to risk, for example by the costs of servicing debt, over-extension of service provision or poor management, they could pose a significant risk for their clients. RPs need to be confident that their suppliers and partners have robust continuity arrangements in place, with all parties aware of the issues and implications of supply chain failure.

GOVERNANCE FAILURES

THE SOCIAL HOUSING SECTOR IS IN A STATE OF TRANSITION. A NEW REGULATOR AND REGULATORY FRAMEWORK WERE INTRODUCED ON 1 APRIL 2012. MORE CHANGES ARE TO COME AS A RESULT OF THE WELFARE REFORM ACT. RPs COULD FACE RISKS ASSOCIATED WITH ORGANISATIONAL TRANSFORMATION TO COMPLY WITH THE NEW REGIME.

The Homes and Communities Agency (HCA), which replaced the Tenant Services Authority as the social housing sector regulator for England on 1 April 2012, published its *Sector Risk Profile*[15] in June 2012. The central feature of the co-regulatory system is that RPs are responsible for managing their own businesses, including their own risks, giving assurance to the regulator on how they are managing these risks. The Risk Profile says that the amount of assurance required will depend upon the risks that each provider faces.

The report also points out that the reduction in grant levels and the subsequent need for greater cross subsidy for new supply has led some providers to consider greater business diversification and the development of other activities including market rent, commercial housing and the provision of housing services to others. "Whilst all of these activities can be a useful source of additional income, they are also debt hungry in the early stages and often require a different skill set to the core social housing activity," warns the HCA. In theory, if the HCA considers that any diversification involves a level of activity/risk that exceeds a provider's capability or threatens its core role, it might impose the same strictures that have taken place in the banking sector, ie ring-fencing ancillary activities and risks.

Regulation in the social housing sector is generally becoming greater and more complex. For example, in addition to the Welfare Reform Act, there are management implications associated with the new Regulatory Framework[16], board appointments[17], new tenure arrangements[18] and transparency[19].

Zurich Municipal believes that most RPs will not find that the regulator's requirements conflict with their own established management practices. But they may have to dedicate more time and management capacity to providing the level of assurance required. Furthermore, the greater complexity associated with the significant tranche of new regulations could mean that some aspects fall outside the existing skill sets within the RP's management.

Strategies to meet the new challenges include ensuring that board and executive management skills are geared to meeting new requirements, including any planned diversification, and the recruitment of skilled non-executive board members with knowledge of best practice governance requirements.

PENALTIES OF GOVERNANCE FAILURE

Failure of RPs' governance and/or the provision of adequate and convincing assurance to the HCA could result in a significant major incident.

- The HCA could insist upon the appointment of consultants to advise on and help implement 'root and branch' reform – a development that would not be conducive to maintaining or building upon relationships with lenders and investors.

- There is at least one past example where an RP's perceived mismanagement alienated banks which refused access to funding.

- The increasing requirement for skilled and experienced board members could place financial pressures on RPs trying to recruit from a limited pool of talent. Economic market drivers could lead to less knowledgeable management teams entering into contracts which do not provide the anticipated returns or which involve unskilled service providers.

- RPs are responsible and accountable for the quality of their governance framework and policies. Outsourcing key aspects, such as audit, to inexperienced suppliers could lead to very real regulatory and financial consequences for the provider concerned.

- Providers who fail to accurately define their risk appetite (the amount of risk exposure, both positive and negative, they are prepared to seek and accept) and align this realistically with their risk tolerance (the amount of risk that they can reasonably manage or tolerate) could be in breach of the HCA's requirements.

- Governance failures, if not apparently financially serious in themselves, can result in follow-on incidents, which may combine to form a major incident. For example, in-house (governance) failure to implement adequate data security provisions can lead to data breach, financial penalties and loss of reputation and financing.

MAJOR FIRE/EXPLOSION

TRADITIONALLY, MAJOR INCIDENTS ARE ASSOCIATED WITH EVENTS SUCH AS FIRE AND EXPLOSION. THE SOCIAL HOUSING SECTOR HAS EXPERIENCED A NUMBER OF INCIDENTS ARISING FROM FIRE AND EXPLOSION. THESE RISKS ARE CLEARLY A CONCERN FOR RPS AS THEY HAVE THE POTENTIAL TO CAUSE INJURIES AND FATALITIES AS WELL AS PROPERTY DAMAGE.

A gas explosion such as that which occurred in Irlam, Salford, in 2010[20] can affect a considerable number of properties, with the need to evacuate tenants and rehouse them temporarily or permanently. Repairing and rebuilding properties may be costly and can also take considerable time in some cases.

Major incidents from fires and explosions can be particularly devastating as social housing tenants often comprise vulnerable individuals such as the elderly. In addition, tenants may suffer financial hardship if they are not insured for their home contents. If they have to relocate, there may be additional expenses associated with travel to work or to family and friends.

As part of their prevention strategy, some providers have linked with fire and rescue services, for example providing free home safety visits[21 22], and promoting domestic sprinkler systems[23].

There can be reputational issues associated with social housing property suffering fire or explosion. For example, RPs have to meet their obligations under the Right to Repair scheme. Any failure to fix an urgent problem within the prescribed time period could lead to significant reputational damage if fire or explosion occurred as a result.

This is also the case where poor routine maintenance is a contributory factor. Contractors and sub-contractors generally face financial pressures in the current economic environment and may be looking to minimise costs in their expense base and service delivery. For example, there has been a significant growth in escape of water claims, many resulting from suppliers using cheap plastic fittings in water supply pipes. This also demonstrates the interconnectivity that can exist between major incident risks, linking to the need for good supply chain risk management.

Neil Hardie,
UK Major Incidents Manager Zurich

"RPs may outsource services but they cannot outsource any associated risks. They remain accountable and face reputational damage if their contractor's actions or negligence causes a major incident. Assessment of the quality and capability of contractors and their staff and good supervision of contractors and sub-contractors are essential."

Following a major incident, there is likely to be scrutiny of the quality of the RP's contingency arrangements. Any failure to meet perceived acceptable standards could also have a reputational backlash. Effective policies and procedures need to be in place in advance, along with checks that tenants are not increasing the potential risk, for example by sub-letting to unsuitable occupants.

These contingency arrangements need to align with and link to those of other relevant organisations such as local authorities and fire and rescue organisations to ensure a co-ordinated and coherent overall response. Plans should focus not just on response but also achieving full recovery as quickly as possible.

Reputational damage from major incidents or from experiencing a number of such incidents can have significant implications for RPs. Losing the confidence of their lenders and/or investors will affect their ability to access finance and could jeopardise their future.

RESILIENCE AND CAPABILITY ASSESSMENT

HOUSING LEADERS ARE GENERALLY CONFIDENT IN THEIR PREPAREDNESS AND ABILITY TO RESPOND TO, AND RECOVER FROM, A MAJOR INCIDENT. HOWEVER, THIS CONFIDENCE IS NOT PARTICULARLY ROBUST, AS THEY ARE MORE LIKELY TO SAY THEY ARE FAIRLY - RATHER THAN VERY - CONFIDENT IN RESPECT OF EACH DIFFERENT TYPE OF RISK. WHILST MANY RPS CONSIDER THAT THEY HAVE EFFECTIVE PROCESSES FOR COPING WITH PERCEIVED RISKS, ZURICH MUNICIPAL BELIEVES THAT THEY MAY NEED TO DIRECT GREATER FOCUS ON THEIR LONG-TERM RECOVERY STRATEGIES.

The following chart shows the potential impact housing leaders regard certain risks as having, along with their ability to respond to each.

Major incident risk associated with financial loss and insolvency is viewed as having by far the highest potential impact, although housing leaders are relatively confident about their ability to respond effectively to this. Major incidents relating to organisational change are seen as having the least amount of impact, and is where the ability to respond is also strongest.

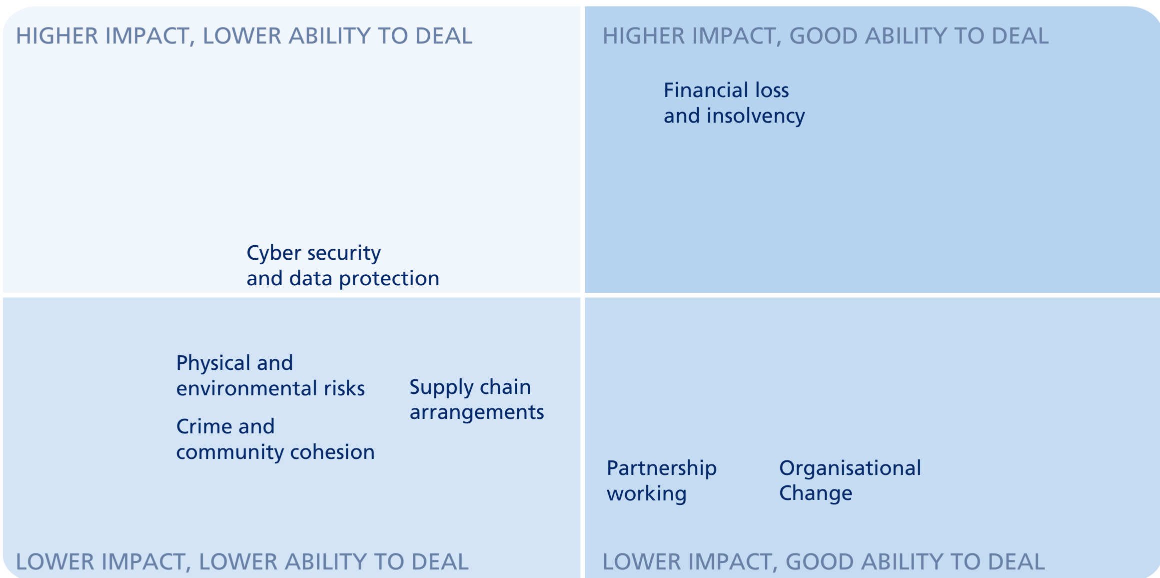
Housing leaders have the least amount of confidence in their ability to respond to a major incident relating to cyber security and data protection, and this is seen to be relatively high impact.

Traditional major incidents such as flood, fire and serious accidents continue to be some of their key priorities in terms of preparing for major incidents.

"WE ARE MOST WORRIED ABOUT MAJOR EXPLOSIONS AND CRASHES AS OUR PROPERTIES ARE ON THE MAJOR FLIGHT PATH INTO GLASGOW. THE RISK IS LOW BUT THESE ARE OUR BIGGEST CONCERNS."

Housing Leader

IMPACT/ABILITY TO DEAL WITH RISKS – HOUSING LEADERS



BASE: All housing sector leaders (16)
Fieldwork dates : 1st March - 19th March 2012
Source: Ipsos MORI

Almost all of the housing leaders who took part in the research are at least fairly confident in their ability to protect sensitive data, although they are more likely to be fairly, rather than very, confident. As we have seen in other sectors, the importance of IT has increased, with third parties relied upon in some cases to keep systems up to date and secure.

"WE ARE MORE RELIANT ON I.T. THAN IN THE PAST – IT WOULD HAVE A BIG IMPACT IF HARDWARE FAILED."

Housing Leader

While some were confident about how they were managing relationships with suppliers, others were concerned that the financial pressures in the economy generally could result in a supplier going bankrupt, thereby disrupting services for their tenants.

"ONE RISK IS A KEY PARTNER GOING INTO LIQUIDATION POTENTIALLY DISRUPTING OUR SERVICES FOR OUR CUSTOMERS."

Housing Leader

In the research we found that housing leaders' response to an external major incident is often the same, regardless of the cause. Their priority is to secure alternative accommodation for their tenants. This often involves relying on other parties, such as local authorities, the emergency services and other housing organisations. Some housing leaders feel they have good working relationships with other organisations, while others feel these could be stronger. One housing leader raised a concern that if they did have to move tenants from their properties, their reputation would suffer because they do not have the capacity to rehouse people.

FACTORS UNDERMINING RESILIENCE

RPs are largely self financing which means that, unlike local authorities, they do not hold unallocated reserves as a back stop to deal with major incidents or other problems. While they are generally considered to be in a stronger financial position than other parts of the public sector, Zurich Municipal believes that welfare reforms and the current economic downturn could erode this.

Insolvency or significant financial loss is a major incident risk for RPs. Furthermore, it cannot be assumed that the private sector would be prepared to take over services should this occur. The likelihood is that the regulator would 'ask' another larger RP to step in.

In the current financial climate, there have been a number of mergers and acquisitions. Whilst a primary driver has clearly been to reduce costs by taking advantage of economies of scale, acquisitions can also arise in response to the need to take over a failing organisation. However, acquiring another organisation which is perceived to be poorly or wrongfully managed can have reputational implications with the acquiring RP's reputation being tarnished by association.

Financial pressures mean that RPs are competing for finance in order to move forward and develop. They are therefore dependent to some degree on the liquidity of the financial markets and how these view social housing investment. The credit rating and lender perception both of the provider concerned and of the wider housing sector may affect an RP's ability to borrow money at preferential rates.

In February 2012, credit rating agency Moody's downgraded the outlook for creditworthiness of housing associations with credit ratings[25] to negative. According to *Inside Housing*, this means that it is more likely that their ratings could be downgraded in the future.

RPs with high levels of gearing have more exposure to risk as minor changes in the financial markets can substantially erode their financial position. Some financial strategies carry a high degree of risk.

For example, in February 2012 *Inside Housing* reported on the financial crisis faced by a large Dutch housing association which was described as "a warning for the United Kingdom's social housing sector[26]." It said that this involved an interest rate swap deal which went wrong. Under interest rate swap deals, associations try to secure lower interest rates by swapping their current rates with those held by investors or banks. In return, the association has to put up security at short notice if rates fall.

According to Dutch media reports, the housing association took out swaps to try and secure cheaper borrowing for loans that did not exist yet. It gambled that interest rates would not fall. When they did it realised it did not have enough security to cover the losses.

KEY RECOMMENDATIONS

WE HAVE IDENTIFIED A NUMBER OF KEY RECOMMENDATIONS THAT THOSE IN LEADERSHIP POSITIONS WITHIN THE HOUSING SECTOR SHOULD CONSIDER. THEY ARE INTENDED TO COVER A WIDE RANGE OF ORGANISATIONS, BUT THEIR SPECIFIC APPLICATION MAY VARY. THIS IS NOT AN EXHAUSTIVE LIST AND RECOMMENDATIONS WILL VARY FROM SECTOR TO SECTOR.

• ENSURE ADEQUATE FIRE RISK ASSESSMENTS ARE UNDERTAKEN

It is essential to ensure that fire risk assessments are completed for multi-tenanted buildings. Assessments need to be tailored to the needs of each building.

- The assessments must take into account communal areas and look to ensure that fires do not spread swiftly, thus reducing property damage and mitigating life safety issues.
- Advice to tenants on fire strategies and fire safety are also vital and should be developed in conjunction with the fire risk assessment. Even simple ‘stay put’ policies can be affected, if the building has been altered, therefore reducing its fire performance – for example if a tenant has changed their front door to uPVC with little or no fire resistance.

• IMPLEMENTING EFFECTIVE RESILIENCE PLANNING FOR THE FUTURE

Over the next ten years housing associations will need to regularly switch between normal mode of operations and crisis management mode of operations. To enable this:

- Housing associations need to be well versed in crisis management techniques. This effectively shapes how an organisation will respond to a crisis situation. This will include stakeholder management such as communication with tenants.
- Housing associations need to revisit their Business Impact Analysis which will prioritise what must be protected in terms of services but identify the range of threat scenarios that could be encountered.
- Test, test and test again. Regular testing of business continuity plans should be undertaken. This will provide regular points of learning and improvements for when the crisis situation does occur.

• SUPPLY CHAIN PARTNERS’ RISK MANAGEMENT AND RESILIENCE PLANS SHOULD MATCH YOUR OWN

If a supplier fails, your organisation is also at risk of failure. To mitigate this:

- Understand the true extent of your supply chain. This should include all partners, contractors and other key reliances. This exercise should highlight vulnerable areas and potential impact of failure.
- Ensure that key partners and suppliers have in place a robust approach to risk management, business continuity and crisis management.

• PROTECT SUSTAINABILITY IN THE NEW FINANCIAL ENVIRONMENT

Financial sustainability is going to be an ongoing challenge. The financial room for manoeuvre should an incident occur is diminishing every year. This is despite the chance of crisis incidents increasing with every year. We suggest:

- In addition to desktop scenario planning, housing associations should stress test their balance sheets for a range of scenarios which could potentially occur. This would inform their approach to contingencies and reserving.

- In the current climate crisis and failure will almost certainly occur, especially in the case of key partners. Housing associations should consider as part of resilience planning both "exit strategies" and "Plan B" options should these situations occur.

• MAKE DATA SECURITY AND INTEGRITY A STRATEGIC PRIORITY

Data breaches, both material and cyber, can be expensive, reputationally damaging and distressing for those whose confidential information has been 'leaked'. We propose:

- Data and cyber risk need to feature as part of corporate risk discussions.

- A detailed assessment of this risk needs to take place to highlight potential vulnerabilities.

• ENSURE YOUR GOVERNANCE ARRANGEMENTS ENCOMPASS THE MANAGEMENT OF RISK

The recent change across the broader business landscape and specifically within the housing sector to a less invasive regulatory approach places a strong reliance on the Board and senior leaders to govern the organisation effectively and provide a sound and robust level of assurance internally and externally to key stakeholders. Within this environment:

- Housing associations need to ensure that Board members are engaged with risk management and have the skills to understand and challenge the risks faced.

- Board members need to be proactively engaged to define the risk appetite of the organisation. This will set in clear terms the appetite and tolerance for risk.

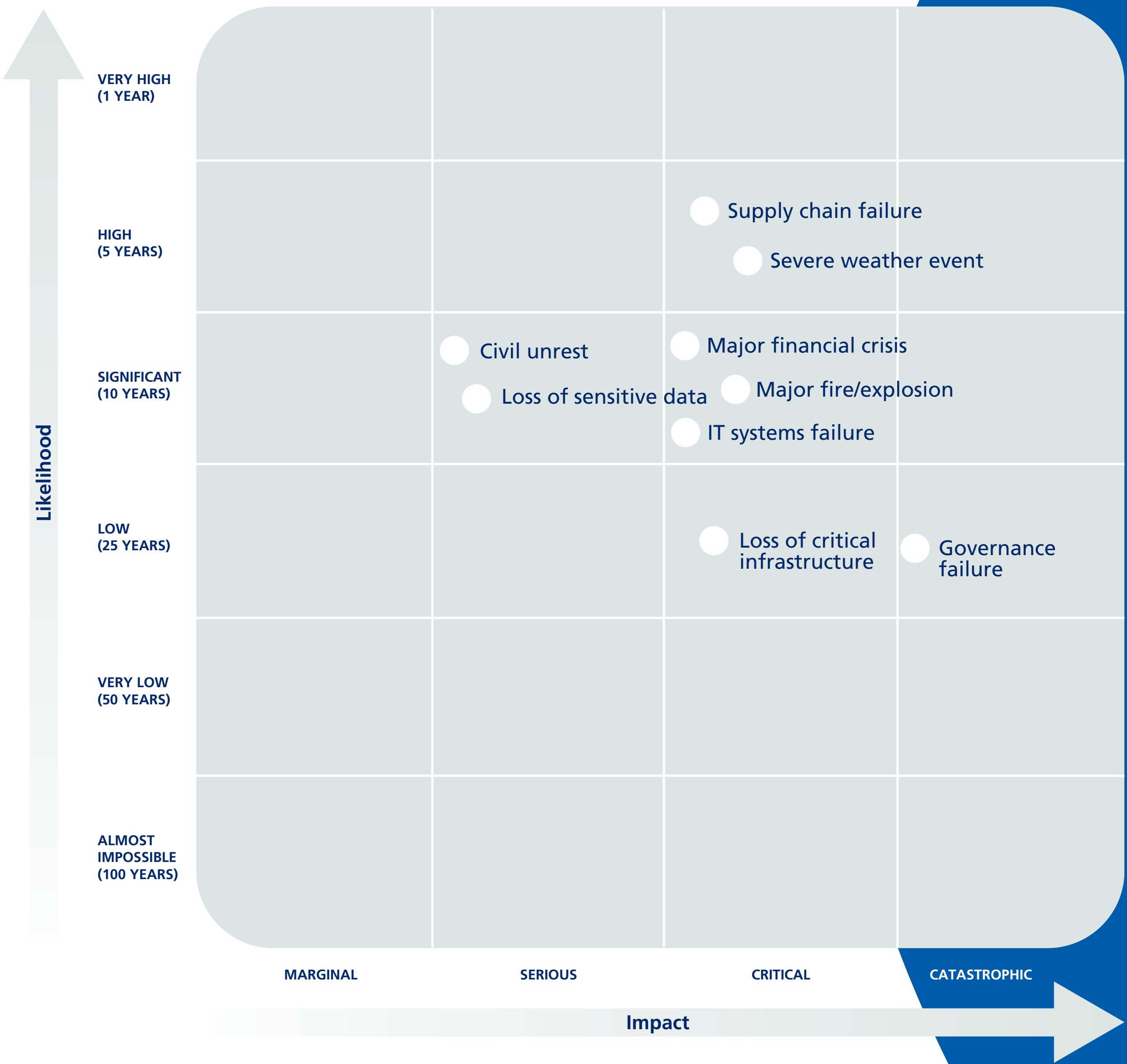
• PROTECT REPUTATION

The brand and reputation of housing associations is going to come under increasing threat over the next few years as a result of current economic measures and risk trends. We would recommend that housing associations:

- Undertake an analysis of key threats to reputation and brand and consider where possible preventative controls.

- Review their crisis plans to ensure that communication during a crisis is robust (speed of messaging, consistency, key stakeholders covered).

SOCIAL HOUSING RISK RANKING



RISK RANKING METHODOLOGY

Harnessing experience working with front line organisations, Zurich Municipal market and technical experts reviewed major incident risks (insurable and non-insurable) for each area of the public sector, in this case for the Social Housing sector. The experts assessed the risks and impact for the generic organisation, the wider sector and the local communities they serve – over the next 5 years. A best practice total risk profiling (TRP) methodology lead to an evidence-based prioritisation. The end result represents Zurich Municipal's best assessment of the risks and challenges facing the Social Housing market. The risk ranking is not meant to reflect the specific risk profile of any one organisation.

RANK	RISK	TREND INDICATOR
1	**SUPPLY CHAIN FAILURE** DISRUPTION TO THE SUPPLY CHAIN OF A HOUSING ORGANISATION, DUE TO GOVERNANCE FAILURE, INSOLVENCY OR ANY OTHER CAUSE OF DISRUPTION	↑
2	**SEVERE WEATHER EVENTS** IMPACT AS A RESULT OF SEVERE WEATHER EVENTS SUCH AS FLOODING, WINDSTORM, SNOW AND DROUGHT RESULTING IN DAMAGE TO PHYSICAL ASSETS AS WELL AS CAUSING SIGNIFICANT DISRUPTION TO TRANSPORT AND COMMUNICATIONS WHICH CAN STOP STAFF AND PUBLIC ACCESSING FACILITIES	↗
3	**MAJOR FINANCIAL CRISIS** A SITUATION WHERE A HOUSING ORGANISATION (OR ONE OF ITS SUPPLIERS/PARTNERS) HAS INSUFFICIENT RESOURCES TO DELIVER ITS OBJECTIVES, TRIGGERED BY INTERNAL FACTORS SUCH AS A FINANCIAL GOVERNANCE OR PLANNING FAILURE, OR EXTERNAL FACTORS SUCH AS A SUDDEN DECREASE IN FUNDING	↗
4	**MAJOR FIRE/EXPLOSION** A SIGNIFICANT FIRE AFFECTING A HOUSING ORGANISATION LEADING TO A SIGNIFICANT DISRUPTION OF SERVICE AND CAPACITY	↗
5	**IT SYSTEM FAILURE** THE LOSS OF IT SYSTEMS OR PROCESSES THAT LIMIT A HOUSING ORGANISATION’S ABILITY TO DELIVER ITS SERVICES	→
6	**GOVERNANCE FAILURES** FAILURES IN EXISTING GOVERNANCE ARRANGEMENTS THAT MAY ARISE DUE TO OPERATIONAL TRANSFORMATION OR LEGISLATIVE CHANGE, EG THROUGH A LACK OF TRANSPARENCY AND AGREEMENT AMONGST SUPPLY CHAIN PARTNERS	↑
7	**CIVIL UNREST** ONE OR MORE FORMS OF DISTURBANCE CAUSED BY A GROUP OF PEOPLE, TYPICALLY A SYMPTOM OF, AND A FORM OF PROTEST AGAINST, SOCIO-POLITICAL PROBLEMS	→
8	**LOSS OF SENSITIVE DATA** THE LOSS OF SENSITIVE PUBLIC DATA, RECORDS OR ASSOCIATED INFORMATION BY A HOUSING ORGANISATION OR ONE OF THEIR PARTNERS/PROVIDERS	↗
9	**LOSS OF CRITICAL INFRASTRUCTURE** LOSS OR UNAVAILABILITY OF A KEY ASSET, IE BUILDING, SITE, BRIDGE, RAIL DUE TO THE IMPACT OF A MAJOR INCIDENT	↗

RESEARCH METHODOLOGY

In order to gain a broad and balanced picture, both quantitative and qualitative, of how public sector organisations view major incidents, Zurich Municipal employed several different approaches:

1 **Ipsos MORI, in association with Zurich Municipal, used a mixed methodology approach to achieve insight into the risks facing the public sector among three key groups:**

- **Public sector leaders;**
- **Experts and academics; and**
- **The general public.**

Firstly, Ipsos MORI carried out 36 qualitative interviews with public sector leaders and nationally representative organisations from local Government, community and social organisations (CSOs), education, housing, emergency services and health organisations, to understand which risks public sector leaders and experts are most concerned about. Quotas were used to ensure an even spread across each sector. The telephone interviews, lasting approximately 30-45 minutes, were conducted from 8th February to 12th March 2012.

Ipsos MORI then undertook research with public sector leaders to quantify the findings from the initial qualitative research. Between 1st March and 19th March 2012, Ipsos MORI carried out 127 quantitative telephone interviews with chief executives or board-level directors across the public sector, lasting between 10-15 minutes. The number of interviews carried out in each sector is shown in the table below.

Quantitative interviews with public sector leaders	
Local Government	34
CSOs	15
Education	17
Housing	16
Emergency services	24
Health organisations	21

The findings from these interviews were supplemented with quantitative research with the general public through Capibus, Ipsos MORI's face to face omnibus. Ipsos MORI conducted 1,033 interviews with people aged 18+ across England, Scotland and Wales. The fieldwork was carried out between 30th March – 5th April 2012. Data were weighted to the known profile of the population.

Ipsos MORI also conducted four qualitative interviews with experts and academics. These telephone interviews were conducted from 30th April to 29th May 2012.

Ipsos MORI and Zurich Municipal would like to thank all the public sector leaders, experts and members of the public who took part in the research.

2 **The Chartered Institute of Public Finance and Accountancy (CIPFA), in association with Zurich Municipal, designed and implemented an electronic (email) survey of Chief Financial Officers (CFOs) to understand more about their perceptions, impacts and preparedness around major incident risks.**

CFOs working within central government, local government, health, non-departmental public bodies, and third sector organisations were invited to participate.

The survey ran between 2nd March to 27th April 2012. Reminders were issued at various points and were supported by a telephone campaign to boost response. In total 79 responses were received.

3 **Risk management journalist Sue Copeman conducted five qualitative interviews with risk management experts during May and June 2012.**

REFERENCES

1 Welfare reform, 2012, dwp.gov.uk, www.dwp.gov.uk/policy/welfare-reform/

2 Localisation issues in welfare reform, June 2011, publications.parliament.uk, www.publications.parliament.uk/pa/cm201012/cmselect/cmcomloc/1406/1406vw14.htm

3 News, 2012, ucnotes.co.uk, www.ucnotes.co.uk/News.aspx

4 Communities and Local Government Committee publishes report on new housing supply, 7 May 2012, parliament.uk, www.parliament.uk/business/committees/committees-a-z/commons-select/communities-and-local-government-committee/news/new-housing-supply-report/

5 Build now or pay later? Funding new housing supply, 25 October 2011, ippr.org, www.ippr.org/publications/55/8116/build-now-or-pay-later-funding-new-housing-supply

6 Isos head office reopens after flooding, 3 July 2012, isohousing.co.uk. www.isoshousing.co.uk/news/news.htm?pk=348

7 After the Riots, The final report of the Riots, Communities and Victims Panel, 2012,2012, ritospanel.independent.gov.uk, riotspanel.independent.gov.uk/wp-content/uploads/2012/03/Riots-Panel-Executive-Summary-and-Recommendations.pdf

8 Thousands of tenants' details found on memory stick left in a London pub, 4 August 2011, ico.gov.uk, www.ico.gov.uk/news/latest_news/2011/thousands_of_tenants_details_found_on_memory_stick_left_in_pub_04082011.aspx

9 NHS Trust fined £325,000 following data breach affecting thousands of patients and staff, 1 June 2012, ico.gov.uk. www.ico.gov.uk/news/latest_news/2012/nhs-trust-fined-325000-following-data-breach-affecting-thousands-of-patients-and-staff-01062012.aspx

10 Viability and planning tools, 2012, homesandcommunities.co.uk. www.homesandcommunities.co.uk/ourwork/viability-planning-tools

11 Supply chain self assessment, 2012, housing.org.uk, www.housing.org.uk/policy/finance/risk/supply_chain_self_assessment.aspx

12 Supply Chain Resilience 2011, Business Community Institute, November 2011, www.bcifiles.com/SupplyChainResilience2011PublicVersion.pdf

13 One year on: The impact of Rok's demise, 10 November 2011, cnplus.co.uk, www.cnplus.co.uk/one-year-on-the-impact-of-roks-demise/8622354.article

14 Care homes: Southern Cross failure 'may be repeated', 6 December 2011, bbc.co.uk, www.bbc.co.uk/news/health-16035012

15 Sector Risk Profile, June 2012, homesandcommunities.co.uk, www.homesandcommunities.co.uk/sites/default/files/our-work/sector-risk-profile-120607.pdf

16 New regulatory framework: Federation briefing, 14 May 2012, housing.org.uk, www.housing.org.uk/publications/find_a_publication/governance_and_regulation/new_regulatory_framework_fede.aspx

17 Board member appointments: briefing on shareholding membership, 20 September 2011, National Housing Federation, www.housing.org.uk/publications/find_a_publication/governance_and_regulation/board_member_appointments_bri.aspx

18 New tenure arrangements, 26 June 2012, National Housing Federation, www.housing.org.uk/publications/find_a_publication/governance_and_regulation/new_tenure_arrangements.aspx

19 Transparency briefing, 6 March 2012, National Housing Federation, www.housing.org.uk/publications/find_a_publication/governance_and_regulation/transparency_briefing.aspx

20 Incident in Irlam – history, City West Housing Trust, www.citywesthousingtrust.org.uk/incident-irlam-history

21 Partnership approach aims to prevent fires in social housing in the Scottish Borders, 16 April 2012, Lothian and Borders Fire and Rescue Service, http://lbfire.wordpress.com/2012/04/16/partnership-approach-aims-to-prevent-fires-in-social-housing-in-the-scottish-borders/

22 Partnership to improve fire safety, Coastline, http://www.coastlinehousing.co.uk/Newpartnershiptoimprovefiresafety.html

23 Signing of Lead Fire Authority Partnership Scheme, 3 May 2012, Derbyshire Fire and Rescue Service, www.derbys-fire.gov.uk/news/news-items/signing-of-lead-fire-authority-partnership-scheme

24 Repairs and maintenance – council houses, www.direct.gov.uk, www.direct.gov.uk/en/HomeAndCommunity/Councilandhousingassociationhomes/Repairsandstandards/DG_188669

25 Ratings cut looms as Moody's downgrades outlook, 17 February 2012, www.insidehousing.co.uk, www.insidehousing.co.uk/finance/-ratings-cut-looms-as-moody%E2%80%99s-downgrades-outlook/6520523.article

26 Dutch landlord financial crisis is a warning for UK, 29 February 2012, www.insidehousing.co.uk, www.insidehousing.co.uk/finance/dutch-landlord-financial-crisis-is-a-warning-for-uk/6520683.article

The information contained in this report is necessarily selective. It does not purport to contain all of the information relating to the subject matter of the report. While Zurich has taken reasonable steps to ensure, as at the date of this document, that the facts which are contained in this report are true and accurate in all material respects, Zurich does not make any representation or warranty as to the accuracy or completeness or otherwise of this report, or the reasonableness of any assumptions on which this document may be based. Zurich accepts no liability whatsoever, and however arising, resulting from the use of, or reliance on this report, or any omissions from or deficiencies in this document.

Zurich Municipal is a trading name of Zurich Insurance plc, a public limited company incorporated in Ireland. Registration No. 13460. Registered Office: Zurich House. Ballsbridge Park, Dublin 4, Ireland.

UK Branch registered in England and Wales, Registration No. BR7985. UK Branch Head Office: The Zurich Centre, 3000 Parkway, Whiteley, Fareham, Hampshire PO15 7JZ.

Authorised by the Central Bank of Ireland and subject to limited regulation by the Financial Services Authority. Details about the extent of our regulation by the Financial Services Authority are available from us on request, FSA registration number 203093. These details can be checked on the FSA's register by visiting their website www.fsa.gov.uk/pages/register or by contacting them on 0845 606 1234.

© Copyright Zurich Insurance plc 2012. All rights reserved. Reproduction, adaptation or translation without prior written permission is prohibited except as allowed under copyright laws.

ZURICH®
MUNICIPAL