



Welcome to the July 2010 edition of the R2A Newsletter

The last few months for R2A has been extraordinary busy. Recent and current commission include project due diligence reviews of the Terrestrial Communications and Centralised Processing bundles of the Sourcing Reform Branch of the Chief Information Officer Group for the Department of Defence, Class W restaurant trams review for Yarra Trams, several very well supported EEA risk & liability management short courses, Tasports Centralised Port Control due diligence review, Port Hedland POSMS (pilotage operations safety management system) development Valley of the Giants walking trail compliance review for DSE and Warragamba Dam drum gate FMECA for MWH.

The R2A SIL allocation workshop and briefing at the Portside Centre in Sydney for 13 July has been sold out.

In addition to the above commissions, R2A has commenced work on the 8th edition of the R2A text titled Risk & Reliability - Engineering Due Diligence. The text is due to be published in October in time for the 2011 academic year. 7 Australian universities are expected to use the text in 2011.

One of the more gratifying aspects of the R2A newsletter has been the response from readers. Most editions garner a number of comments to the effect that the feature article was very interesting and generated significant comment/discussion amongst colleagues. It also tempts R2A to consider larger issues, like the GFC, the subject of this months newsletter feature article.

EDUCATION

Risk Management - 2 day Public Course

Richard Robinson continues to present the Risk & Liability Management (Engineering Due Diligence) two-day public short course on behalf of Engineering Education Australia. Remaining dates for 2010 are as follows:

Brisbane: 20-21 October
Melbourne: 3-4 November
Perth: 17-18 November
Sydney: 25-26 August

See the EEA website www.eeaust.com.au for further details and registration.

Engineering Due Diligence (1/2 day briefing)

Melbourne - 12 October
Brisbane - 23 November

Project Due Diligence (1 day workshop)

Canberra - 7 September

Availability Profiling (1 day workshop)

Perth - 10 August

SIL Allocation (1 day workshop)

Perth - 28 September

For further information about these briefings and workshops visit our website <http://www.r2a.com.au/ap.php> or contact Amy at training@r2a.com.au.

Amy Scott has been appointed R2A Office Coordinator in Melbourne.



Due Diligence Briefing to WA Department of Mines

On Tuesday 22nd June, Richard Robinson and R2A Associate Mike Dean briefed WA State Mining Engineer Simon Ridge, Dangerous Goods Director Philip Hine and Manager of Major Hazards Peter Macrae on the implications of the federal governments due diligence concept embodied in the Model Work Health and Safety Bill, planned to be implemented by intergovernmental agreement in Australian jurisdictions by 1 January 2012. This act specifically includes the storage and handling of dangerous goods and will apply to both onshore and offshore activities.

It was recognised that the new Act would have implications for major hazards, dangerous goods and the mining industry although the scope of such is yet to be determined.

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The GFC

The GFC (global financial crisis) has been an issue of considerable frustration to long term participants in the risk business. It basically has bought the overall risk business into disrepute and, as technologically based observers, is not yet being addressed as seriously as it should.

The Economist Magazine of February 13th-19th has a feature 14 page special report on financial risk. It points out the rise of the 'quants' (PhD mathematical modellers) and the rise of the belief that all risk could be managed using such tools. The general tenor of the articles is that, whilst there were concerned individuals, the overall view was something along the lines: "What's the problem - we're making money". This is a very powerful argument.

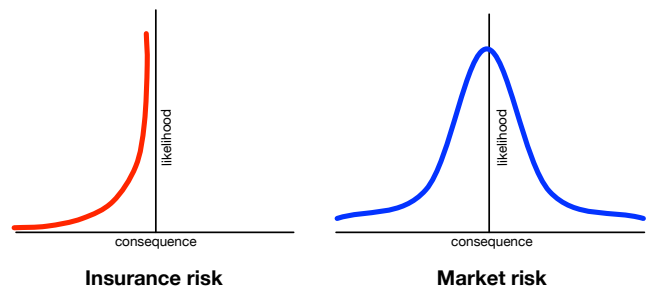
Money Isn't Real. But it does not seem to us at R2A that the underlying philosophical issues are being addressed. At a recent dinner with an executive from Merrill Lynch, the observation by R2A that money wasn't real was greeted with surprise. The point was that money does not exist in a state of nature, for example, it does not grow on trees.

Money is a very useful, possibly essential, human construct that acts as a medium of exchange of represented real world values. The recent disconnection is perhaps exemplified by a current television advertisement that suggests that investors in the financial markets should keep an eye on the real world as sometimes events that happen there can also affect the markets. Presumably, the psychology of the markets is seen to be more important than the reality of the performance of the real economy.

From a public policy viewpoint, anything that distorts the real world - reality exchange 'rate' must be considered bad. Asset bubbles, inflation, deflation and bank bailouts are all evils presumably because they distort the correlation between money and the perceived value in the real economy. Market forces are supposed to remedy such disconnects. Such a view suggests that the value that credit rating agencies bring to the table is to ensure a tight correlation between money and real world economic reality.

Risk management as it first emerged in Australia in the 70's and 80's came from the insurance world and was aimed at the management of downside risk, the risk from which there is no prospect of gain. Typically risk assessors worried about death and injury, asset damage and business interruption and environmental contamination. These issues were translated into money in the form of insurance policies. This perceived value was typically revisited each year to determine the premium to be paid. And whilst, underwriters might be pessimistic or optimistic about particular customers, the reality of the risk being underwritten was never in doubt.

The financial markets only really drifted into the financial risk modeling in the mid 90's. They assume that risk is symmetrical about the mean, that upside and downside risk are equivalent. To outsiders, looking in, the near demise of Long-Term Capital Management (LTCM) and subsequent bail out by Wall Street as well as the Enron, HIH and One Tel collapse make alarming reading but the financial sector recovered fast. Concerned risk presenters at company directors briefings didn't last long.



The issue is that the tangible connection to reality is lost. The agglomerated security is no longer transparently connected to reality and the value it purports to represent. The derivatives markets is impenetrable to the outsider. Although when the profits from such activity (manipulations?) are returned to reality, those involved (bankers etc) expect equivalent respect for the monetary outcomes as with other ordinary day to day economic activity.

Too Big To Fail. In particular, the concept that some businesses are just too big to fail and need taxpayer support when in crisis has generated extreme angst in many sectors of the community. From a risk perspective it means that the market forces reality test fails. Apart from Lehman Brothers, the downside risk potentials did not really manifest itself to the US bankers. If the financial 'quants' model risk as being symmetrical about the mean and the downside risk is mitigated by the public purse then making money is not quite so hard as it is for those in the real economy. And the wealth transfer is from those in the real economy, both as taxpayers and investors.

Frustratingly, this has all happened before. The Great Depression in the US created the "Truth in Securities Act" of 1933 which promoted the concept of due diligence as a defence for broker-dealers marketing stock offerings. It was all to do with transparency in the markets. The idea was to prohibit deceit, misrepresentations, and other fraud on the sale of securities to the public. As US Supreme Court Justice Louis Brandeis put at the time of the 1933 Act: *sunlight is the best disinfectant*.

Shine on.