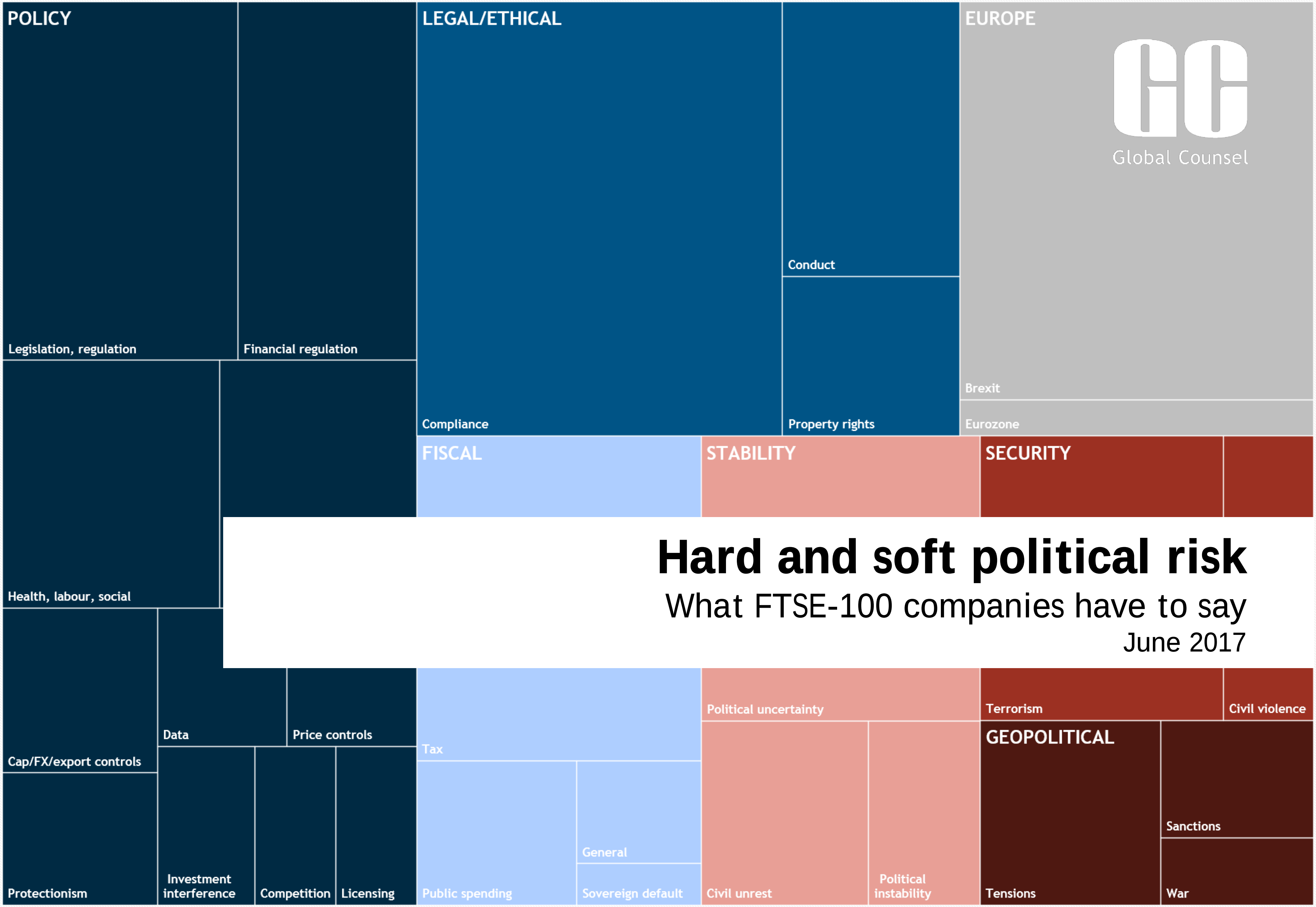

Hard and soft political risk

What FTSE-100 companies have to say

June 2017

Preface

This report assesses the political risks faced by FTSE-100 companies around the world. It does so by looking at the political risks the companies themselves identify in their annual reports for financial years ending in 2016, which were published in a cycle running from May 2016 through to May 2017.

We use a broad definition of political risk. We look at the hard risks that are traditionally associated with political risk, concerning geopolitical tensions, security threats and political stability. We also look at soft risks concerning regulation, the legal environment and taxation, which all have a political dimension. And we look at Europe risks, which have both hard and soft elements, with Brexit being the prime example.

In our analysis, we identify the countries and regions where the risks originate. We also consider which companies and sectors are the most exposed to different types of risk.

This is the second political risk report produced by Global Counsel. Our first report, published in June 2016, identified the political risks for FTSE-100 companies in financial years ending in 2015. We have used a similar methodology, allowing us to assess whether risks have increased or decreased over the past 12 months.

We conclude that while both hard and soft risks matter for FTSE-100 firms, it is soft risks that are the bigger concern, and increasingly so. We also conclude that the UK is now the single biggest source of political risks for the FTSE-100.

Gregor Irwin
Chief Economist, Global Counsel

About Global Counsel

Global Counsel is an advisory firm that helps companies and investors across a wide range of sectors to anticipate the ways in which politics, regulation and public policymaking create risks and opportunities. We also help companies to develop and implement strategies to meet these challenges.

Global Counsel can provide retained support in specific markets or policy areas, or build teams to embed alongside strategic decision makers for projects or transactions. Our work is backed up by high quality analytical content that is politically and economically informed and which builds quickly into executable strategy.

Our team is led by former public policymakers and political advisors with experience at the highest level of government and policymaking. We have offices in London, Brussels and Singapore, backed by an international network.

The author of this report is Dr Gregor Irwin, Chief Economist at Global Counsel. Dr Irwin was the Chief Economist of the British Foreign Office from 2008 to 2013. He has also previously held senior positions at the Bank of England and the British Treasury.

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The political risks faced by FTSE-100 firms are increasing and they are changing. The number of risks reported rose to more than 450 this year, from just over 300 last year. This reflects a sharp rise in political uncertainty following major ballot box surprises over the past 12 months and further elections in Europe this year. It also reflects the uncertainty about policy choices affecting business that has resulted.

Overall, we find a small fall in the number of hard political risks, but a sharp rise in soft political risks. The rise in soft risks - regarding public policy, fiscal policy and legal and ethical risks - may be partly because companies are becoming more aware of these risks. It is almost certainly also because the political environment has changed with soft risks now significantly heightened for many firms.

The UK is the single biggest source of political risk for FTSE-100 firms, even leaving aside Brexit. This cannot simply be explained by the geographic importance of the UK as a home market, as most FTSE-100 firms have a very wide geographic footprint. Almost half of UK-based risks concern public policy. Examples include the national living wage, the apprenticeship levy, data protection and Heathrow expansion. Tax policies are another source of concern.

There has been a sharp rise in the number of firms identifying Brexit as a risk, now that the UK has voted to leave the EU. The single most frequent concern is about the uncertainty this has created, as the terms of the UK's future relationship with the EU are unclear. A minority of firms report specific risks about market access, future regulation, labour issues and currency values. 45% of firms don't report Brexit risk at all. Many of the firms that report Brexit risk judge that they are sufficiently diversified to ensure the consequences are manageable.

Donald Trump's election in November 2016 came almost exactly in the middle of the 2016-2017 reporting cycle. It was the stand-out political event of the past 12 months and it has been reflected in the risks identified by many of the companies reporting since then, even though several are still absorbing the potential consequences. Among those that identify Trump-related risks, two themes stand out: the risk of protectionism and fiscal uncertainty. Some businesses see up-sides from Trump's election, while others worry the financial market bounce after the result may have been excessive.

Fewer companies identify the eurozone as a risk this year, with just a handful now noting concerns. Europe is nevertheless a significant source of concern for some companies. Many note the uncertainty created by elections in the Netherlands, France and Germany. So far, the results of these elections have been reassuring for companies and this risk may prove to be transitory. The EU is also a significant source of concern for companies in two particular areas: tax and financial regulation.

In total, almost half of FTSE-100 companies report fiscal risks, with over a third identifying tax policies as a source of concern. Almost one fifth note the potential impact of international negotiations being led by the OECD and G20 to reduce base erosion and profit shifting by international companies. This includes half of the telco and tech firms and a quarter of consumer goods firms. The concern that many companies have is how new tax avoidance measures will be implemented, particularly in Europe. A handful of companies also identify the investigations by the European Commission into tax and state aid as a source of concern.

Concerns about financial regulation are widespread among financial sector firms, with Europe referenced more often than the US or other countries. In some cases, firms are concerned about both regulation that is in the process of being agreed at an EU level and how it will be implemented in the UK. MIFID II, CRD IV and the BRRD are the regulations that are most frequently mentioned.

Executive summary

Concerns about protectionism are not widespread, but they are rising and some firms make a connection to the US election. Some companies identify specific forms of restriction that impact on trade and investment in the form of capital, foreign exchange and export controls. This may be a sign that some companies are feeling a push back against globalisation impacting on a wider range of policies that are disruptive for their business.

We find several companies are concerned about whether they are able to conduct themselves consistently in a way that is ethical and which does not expose them to political risks. In addition to established concerns about bribery and corruption, we found that some companies are focused on the issue of modern slavery, including in their supply chains.

While we found fewer hard risks concerning geopolitics, security and political instability, they still remain important. As well as the destabilising effects of political uncertainty, noted above, there remain a significant number of concerns about tensions between countries, sanctions, terrorism and politically-motivated cyber attacks. Companies are often not specific about the hard risks they face, but where they are we find the risks are more concentrated in emerging countries than other risks.

The emerging countries that are the biggest source of risk are Russia, China and in the Middle East, although none are a source of widespread concern for FTSE-100 firms. Given its economic importance and the complexity of its political environment, we find remarkably few references to China, except as one among several countries. Companies may be reluctant to acknowledge the political risks from doing business in China. Fewer companies identify Russia as a risk this year, perhaps because they have adjusted to sanctions there. The Middle East is a major source of hard risk, with Saudi Arabia and Syria the two countries referenced most often.

We find significant differences in the level and type of political risk that firms are exposed to across sectors. The most exposed are firms in the oil and gas sector, followed by healthcare, basic materials and financials. Both oil and gas firms and financial companies have high exposure to hard risks, the latter because of the political uncertainty created by elections. Financial firms have a high exposure to Europe risk - specifically Brexit - in sharp contrast to oil and gas firms. Healthcare firms have a high exposure to legal and ethical issues. The least exposed companies are in the utilities sector and their concern is primarily public policy, reflecting their domestic focus.

The top political risk reporter - with 20 risks identified - is Shell, followed by RBS and BP. Shell reports on a wide range of hard and soft risks. The public policy issues identified by Shell include climate change, environmental regulation, competition policy, FX controls and local content requirements. RBS's concerns are different and some are legacies of the financial crisis, including state aid conditions imposed by the EU following its government bailout and from the influence of the UK government as a major shareholder in the bank.

As we found last year, some companies are much better than others at reporting risks. The best do so in a way that provides the confidence that investors and other stakeholders need in the management's ability to understand and mitigate the political risks facing the business.

Introduction

The political environment facing large international businesses has rarely been more uncertain or more complicated. Over the past twelve months, the UK has voted to leave the European Union, Donald Trump has become President of the United States, and Dilma Rousseff has been impeached and removed from office as President of Brazil.

In Turkey, a new constitution has concentrated power in the hands of President Erdogan, who has suppressed internal opposition since the coup attempt in July 2016. In France, the established political parties have been pushed aside in the presidential elections, with a party formed less than a year ago winning a landslide majority in the national assembly. In Italy, the prime minister was forced to resign after he failed to reform the constitution and the electoral system, just as the government is attempting to deal with a banking crisis.

Across rich countries, in particular, there are signs that governments are struggling to address the side-effects of globalisation and technological change, which are increasing inequality and fuelling disillusionment with economic models based on openness to trade, investment, and migration.

This political uncertainty has reflected – and created – policy uncertainty. And that political and policy uncertainty has contributed to a proliferation of hard and soft political risks facing business, which means large international companies must now operate in a much more complicated environment.

But how do businesses themselves assess these risks? Which do they judge to be serious, potentially impacting directly on the success of their operations? And which are just background noise?

These questions are addressed in this report, which considers how some of the biggest and most important companies – the FTSE-100 – report on the political risks they face.

Our analysis is based on what these companies say about political risks in their annual reports for financial years ending in 2016, which were published in a cycle running from May 2016 through to May 2017.

The top risks

Overview of risks

In our review of FTSE-100 annual reports, we identified 462 political risks. This is a substantial rise on last year and reflects how political risk has become a fact of life for many companies. It is partly a consequence of heightened political uncertainty from the Brexit vote, the US election, and major elections in the European continent, which are impacting on policy.

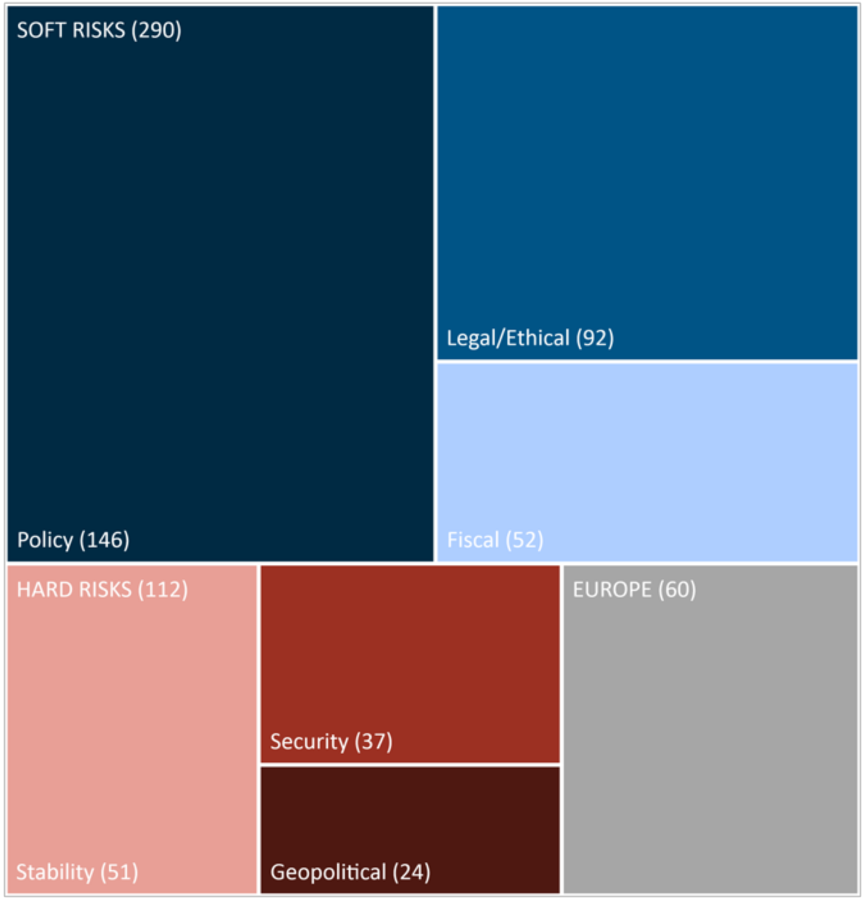
Over half of firms identify Brexit as a risk. This now dominates the other category of Europe risk we look at, concerning the eurozone. Our analysis shows that the intensity of Brexit risk varies considerably across firms, reflecting the extent of their exposure to UK and EU policies, the extent of their diversification internationally, and their net exposures to sterling.

Among the other risks, a large majority - 290 in total - are soft risks. These are risks originating from the public policy, fiscal pressures or the legal and ethical environment in which companies are operating. We found 112 hard risks, reflecting the geopolitical, security or stability concerns that many companies have in the markets they operate in around the world.

57 of the 100 companies reported at least one hard risk, while 95 reported at least one soft risk. We found that all companies, without exception, reported at least one risk, whether hard, soft, or Europe related.

The single biggest category of risks are public policy risks. These range from the very specific – such as AstraZeneca's concern about how reform of Obamacare might affect US prescription costs or import policies - to the much more general. But all require an understanding of the political process and pressures that result in changes to legislation or adverse regulatory outcomes.

The FTSE-100 political risk map
The number of risks reported in each of the main risk categories



The top risks

Overview of risks

When we break down risks into sub-categories, we find the most prevalent are compliance risks. Some of these are overtly political with, for example, Barclays concerned that the scrutiny of global business investment is increasing following the introduction of the Modern Slavery Act in the UK. Many are more generic, with several companies noting that they operate in complex, changing regulatory environments, where enforcement may sometimes be uneven or unpredictable, particularly when the demands on business are open to interpretation.

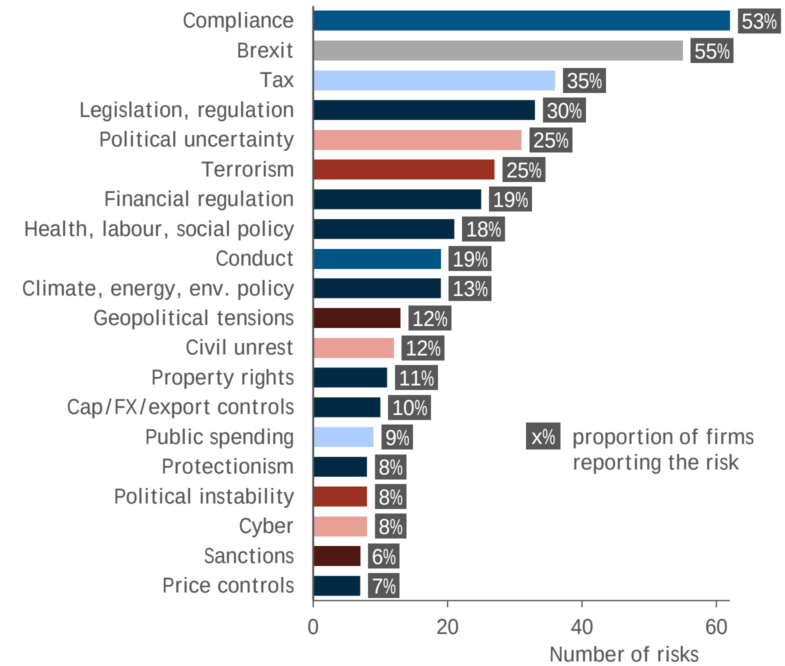
Over a third of companies report risks relating to taxation. Some of these are sector specific, such the LSE's concerns about the possible introduction of a Financial Transactions Tax by some European countries. Others are concerned about broader policy trends. The tax issue most often raised is that OECD and G20-led work to address base erosion and profit shifting by multinationals, has the potential to change tax rules in many countries.

We find a wide range of hard risks, but fewer geopolitical risks than might be expected. The most common hard risk is about political uncertainty in the countries that firms are operating in. Many companies reported concerns about political uncertainty in the US, both in the run up and after the presidential elections. Many others note risks in Europe, with insurgent political movements, often with extreme policies, challenging mainstream parties in general elections in the Netherlands, France and Germany.

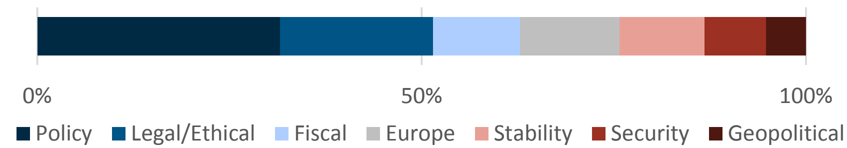
There are some risks that are more notable because they do not appear to be a major concern, at least to FTSE-100 firms. Only one in eight firms identifies geopolitical risks, despite these being high in the Middle East, the South China Sea and in Eastern Europe.

The top twenty risks reported by FTSE-100 firms

Number or risks reported and percentage of firms reporting the risk



The distribution of risks across categories



What’s changed?

Overview of risks

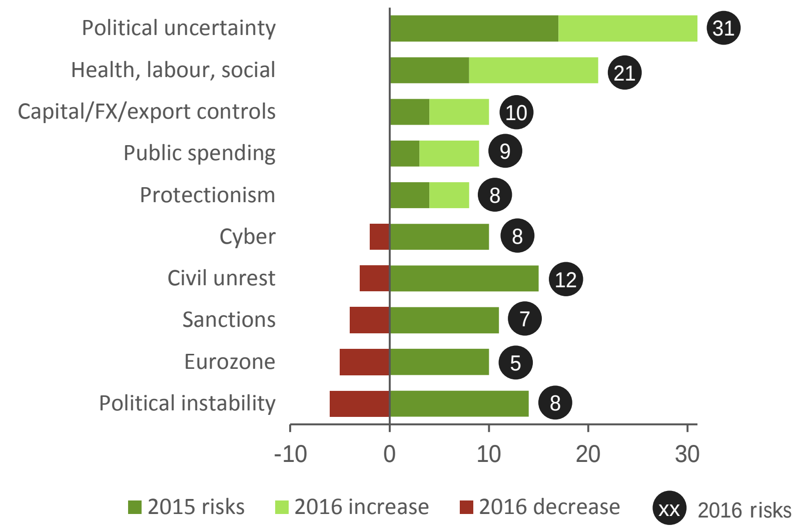
There are some significant changes compared with the risks reported by FTSE-100 firms last year. Some are surprising, others less so. Political uncertainty has increased, reflecting major electoral events. More surprising is there is now less concern about political instability or the collapse of governments. This may reflect a shift in focus from emerging countries – where governments have often been more unstable in the past – to the US and Europe.

Concerns about protectionism have doubled, reflecting worries about the direction of US policy, but these remain small. There has, however, also been a marked increase in concern about other forms of restriction impacting on trade and investment, specifically in the form of capital, foreign exchange, or export controls. This may be a sign that companies are feeling a push back against globalisation, which is impacting on a wider range of policies that are disruptive for their business.

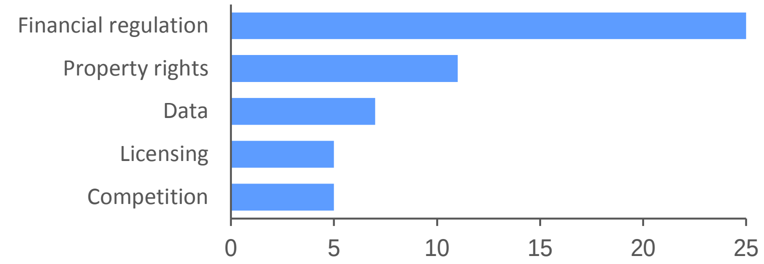
One of the biggest increases has been to risks to health, labour market and social policies. The UK is the single country that is most often identified, with the national living wage, the apprenticeship levy and housing policies among those raised by companies. Very few firms have an appetite to become embroiled in political debate over these policies, but they clearly impact on some businesses.

We have included several new sub-categories of risk this year to better reflect the concerns of FTSE-100 firms. The single biggest is financial regulation, which for some firms in the sector is a source of multiple risks. We also identify concerns about property rights, ranging from protection of intellectual property to disputes over land ownership.

Changes in selected risks identified over the year
Number of risks reported y/e 2016, compared to y/e 2015



New risks considered this year



Political risk across sectors

Overview of risks

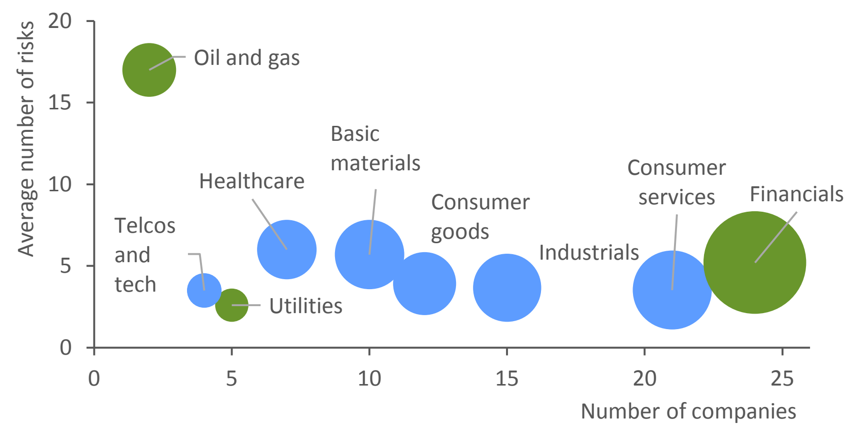
There is wide variation in the level and type of risks reported across sectors. The most prolific risk reporters are in oil and gas, which is also the smallest sector, with just two firms - BP and Shell. Firms in the healthcare, financial services and basic materials sectors are all high risk reporters, each reporting more than five political risks on average.

Oil and gas firms are heavy reporters of hard risks, including geopolitical risks. This reflects the insecurity and instability of the locations that these firms operate in. More surprising is the fact that financial sector firms together report 41 hard risks. These are concentrated among those operating in developing countries, such as Old Mutual, which notes the risks to its business in South Africa, from uncertainty about the country's political leadership, and in Zimbabwe, from social unrest fuelled by tension between President Mugabe and his opponents.

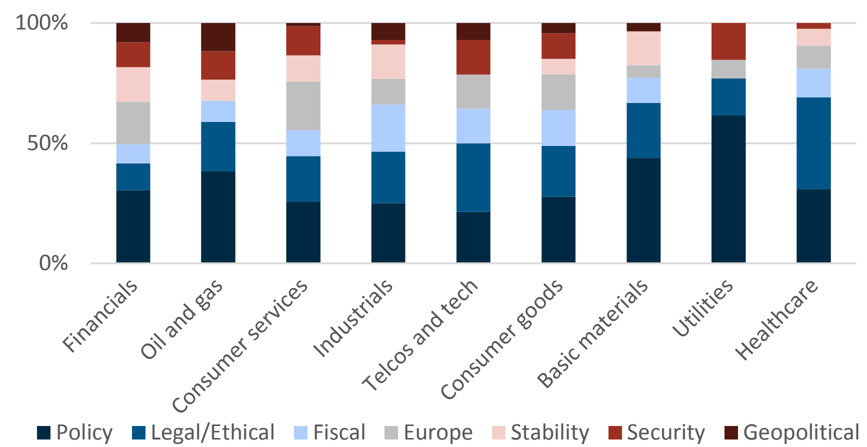
Legal and ethical risks are high among healthcare firms, which together report more of this type of risk than any other sector. These include risks from misconduct, from non-compliance with regulation and to their intellectual property. GSK and Hikma report all three types of legal and ethical risk.

The smallest number of risks - just 2.6 on average - is reported by utilities. The concerns of firms in this sector are heavily biased towards soft risk and particularly public policy risk, with the UK their primary concern, reflecting where they do most of their business. SSE identifies risks to the affordability of energy from government policies, including climate policies, showing how international political agreements can have a direct operational impact on firms.

How the prevalence of risk varies across sectors



How the types of risk varies across sectors



The top and the tail of the distribution

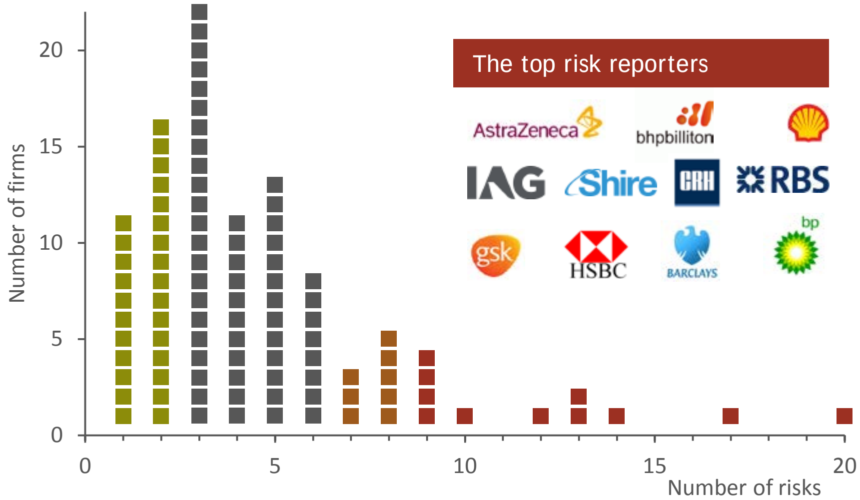
The single biggest reporters of political risk are Shell, with 20 risks by our count. Next is RBS, with 17, and BP, with 14. Another eight companies report nine or more political risks.

Since last year, BG has merged with Shell, broadening the exposure of the group to political risk. Shell's concerns include security in Nigeria, sanctions against Russia and Syria, anti-bribery proceedings in Italy, and data protection and competition law enforcements in the EU. Shell faces a wide range of public policy risks, covering climate change, the environment, competition, FX controls and local content requirement. Shell – like BP and some mining companies - also faces risk to its ability to exert control over its investments in some locations.

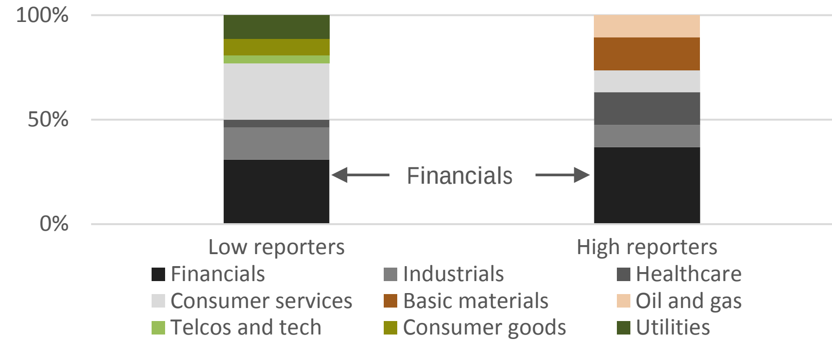
The risks faced by RBS are different, reflecting both the sector and the fact that RBS is part-owned by the UK government. RBS notes risks directly flowing from HM Treasury's influence over the group. The bank also identifies risks that are legacies of the financial crisis, both from compliance issues and the state aid conditions imposed by the EU following the government bailout. RBS identifies hard risks from sanctions, terrorism and geopolitical tensions. And it identifies the political uncertainty from a possible second Scottish referendum. But the most widespread risks for RBS are policy risks, most obviously from financial regulation, but also from protectionism and competition policy, which it says is changing competitive dynamics.

Just over a quarter of firms report two risks or fewer. Consumer goods firms and utilities are among the low reporters. Financial sector firms are found among high and low reporters. That is partly because this broad sector includes property developers and several financial firms with simpler business models than the larger and more international banks.

The risk distribution across FTSE-100 firms



The sector distribution of low and high risk reporters
Low reporters with 1 or 2 risks; high reporters with 7+



The geography of political risk

Risks by geography

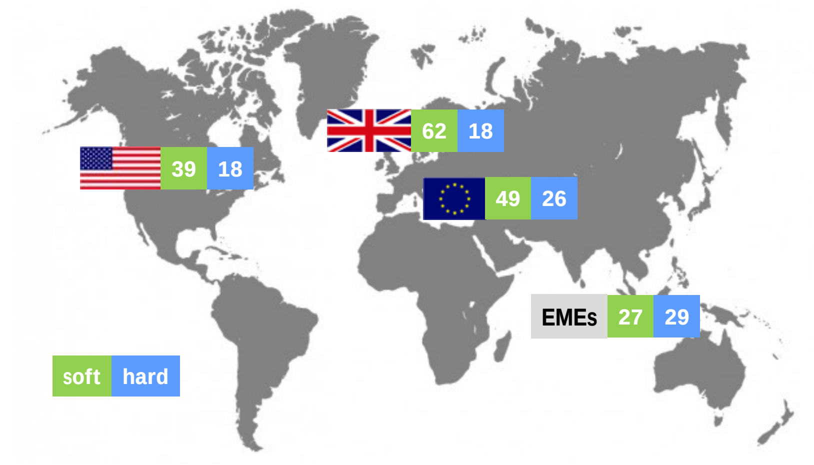
The UK is the main source of political risk for many FTSE-100 firms. Even leaving aside Brexit risks, we found that 43 firms together reported over 80 UK-based risks, averaging almost two per company. Over three-quarters of these are soft risks and around half are public policy risks. This is more than the number of risks reported for either the whole of the rest of Europe and the EU combined, the US, or emerging economies.

Among the risks affecting the rest of Europe, we find some 40 that specifically refer to the EU and another five that refer to the eurozone. There were fewer eurozone risks reported this year, but some concerns remain, with RBS, Lloyds and Legal & General all noting that financial stability risks still exist.

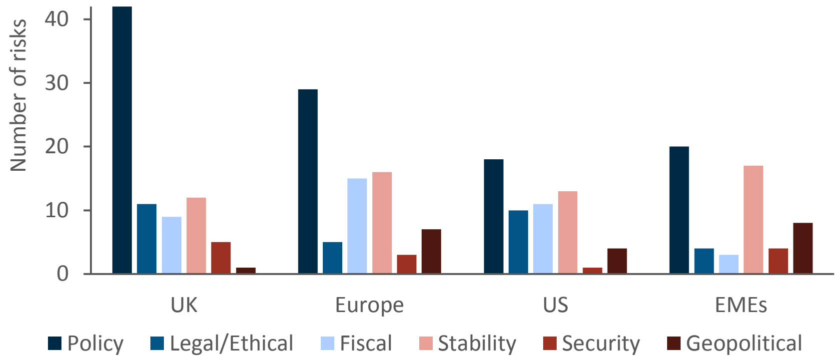
FTSE-100 companies rarely report specific risks in individual European countries, except the UK. Beyond the political uncertainty around elections, noted above, almost all specific risks are entirely idiosyncratic to the reporting firm, such as Aviva's concerns about potential changes to pensions in Poland, which it believes could radically impact on the industry there.

After the UK, the single country that is most often identified by FTSE-100 firms is the US. In the rest of the world, outside Europe and the US, there is no single country that stands out as a source of risk. There are remarkably few references to China, except as one among a number of countries. This may reflect a reluctance by some companies to acknowledge the risks they face in China. There are six references to Russia as a source of hard risk, which is fewer than last year. The other region that is a major source of risk is the Middle East and North Africa, which is a source for 18 risks. Hard risks are the most common, with Saudi Arabia and Syria the individual countries that are referred to most often.

The geographic sources of FTSE-100 political risk
Number or risks where the geographic area is referenced



The types of political risk by geographic source



UK risk: more than Brexit

Risks by geography

UK risks are largely concentrated in just four sectors: financials, industrials, consumer services and utilities. Together, these sectors account for over 85% of all UK risks, excluding Brexit. When we look at the propensity for firms to report UK risks across sectors, a different picture emerges, with the average number of risks per firm significantly higher for utilities and financials.

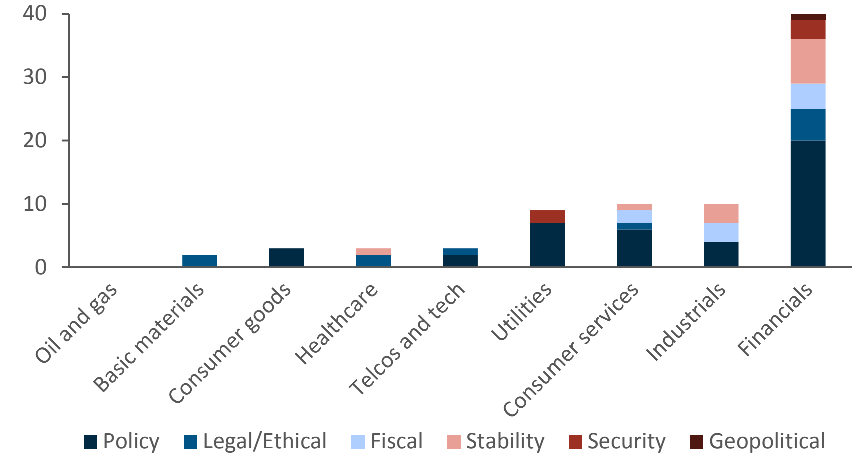
Public policy risks account for over half of UK risks. The issues identified by FTSE-100 firms include the national living wage, the apprenticeship levy, privacy and data protection, media regulation, Heathrow expansion and intellectual property protection.

Twelve firms identify financial regulation as a source of risk in the UK. These include the housebuilder Taylor Wimpey, which notes uncertainty about the Help-to-Buy equity loan scheme and how financial regulation impacts on mortgage availability and the demand for new housing. Some of the other concerns are about how the UK implements regulation agreed at the EU level. Asset managers have a particular concern about the FCA's asset management market study, which is still progressing following the publication of an interim report in November 2016.

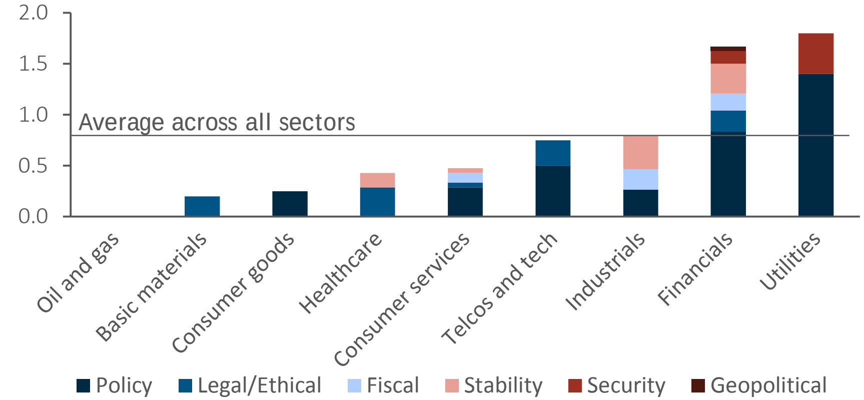
Among legal and ethical risks, there are some long-standing concerns about anti-bribery conduct and compliance. However, some companies are now also identifying human rights and the new Modern Slavery Act as a source of scrutiny and risk for their business.

There are several fiscal risks identified. Some of the specific UK tax concerns raised include business rates, stamp duty, the new insurance premium tax and VAT treatment. Among defence contractors, there are concerns on the spending side too, specifically regarding the Ministry of Defence budget.

Total UK risks by type (excluding Brexit) across sectors



Average number of UK risks (excluding Brexit) across sectors



Risks in Europe: tax and financial regulation

Risks by geography

A bigger share of risks in Europe are hard risks - 35% - than risks in either the US or the UK. This mostly reflects political uncertainty surrounding the outcome of major elections in 2017 and, to a lesser extent, geopolitical risks in Europe's southern and eastern neighbourhoods. There is significantly less concern about legal and ethical risks than there is for either the US or the UK.

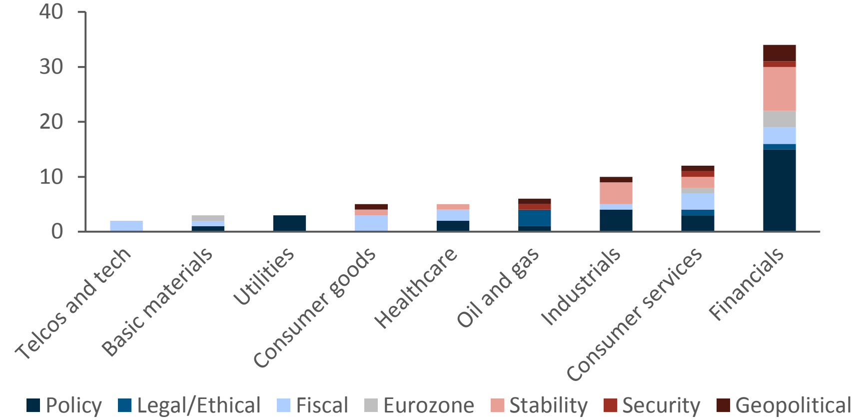
The EU is a notable source of tax risks, which are reported by 13 companies. Some are general concerns about the OECD's base erosion and profit shifting agenda, discussed in more detail on page 19. Others are more specific. GSK, Reckitt Benckiser and Micro Focus each refer to the European Commission's fiscal state aid investigations, which have been one of the highest-profile and most contentious EU initiatives over the past two years. This has involved challenging the tax treatment of companies, many of which have high value intellectual property, where the EU contests this amounts to special treatment and an unfair subsidy.

A number of companies identify specific public policy risks emanating from the EU. These include concerns by Pearson, Legal & General and WPP about the new General Data Protection Regulation, which will reform and converge data privacy laws across the EU and become effective in 2018. The biggest concern by far, however, is financial regulation. Ten firms report risks in this area, with many of them identifying several directives or regulations that are of concern, with MIFID II, CRD IV and the BRRD the most frequently mentioned.

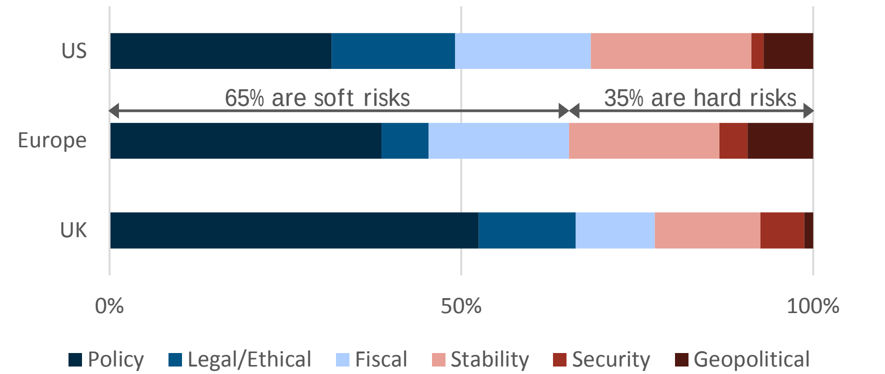
Some concerns remain about the eurozone, but fewer than last year. RBS, Lloyds and Legal & General all note that financial stability risks still exist in the single currency area, with L&G specifically concerned about residual weaknesses in the banking system.

Types of Europe risk across sectors

Note: this excludes UK-only risks



Distribution of Europe risks compared



US risk: the Trump factor

Risks by geography

The stand-out risk in the US is from the election of Donald Trump. 18 firms reference either Trump, the presidential election or the new administration in their description of 21 risks, despite the election taking place at the midway point in the reporting cycle.

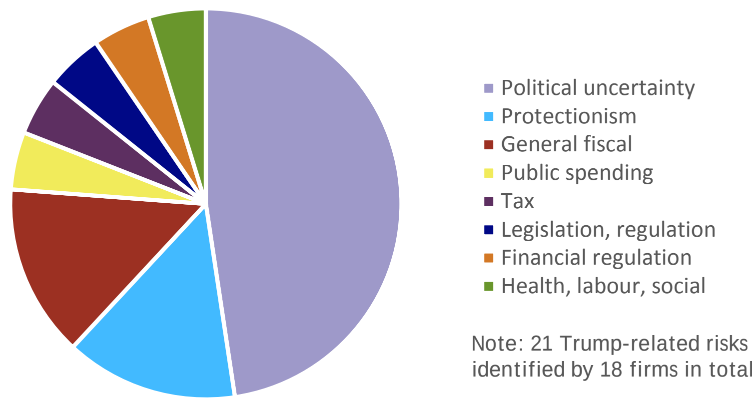
Almost half the risks focus on the political uncertainty created either before or soon after Trump's unexpected win. Not all are negative, with Informa describing the mood in the US after the election as "europhoric" while noting that whether the optimism is rewarded depends on "how the Trump administration performs".

Three financial firms - HSBC, Standard Chartered and Old Mutual - link Trump's election to the risk of protectionism. Old Mutual is specifically concerned about hostility being directed towards China, which could result in a more general sell-off of emerging country assets.

Several companies report concerns about fiscal policy uncertainty, on both the tax and spending sides. Their precise nature varies and needs to be understood in the context of exactly when the firms were reporting. When Old Mutual reported, it was concerned the market may have over-estimated the fiscal stimulus that will follow under the Trump administration. Bunzl focused instead on uncertainty over tax reform, noting this could be either positive or negative. Rolls Royce and BAE Systems reported uncertainty about the implications for defence spending.

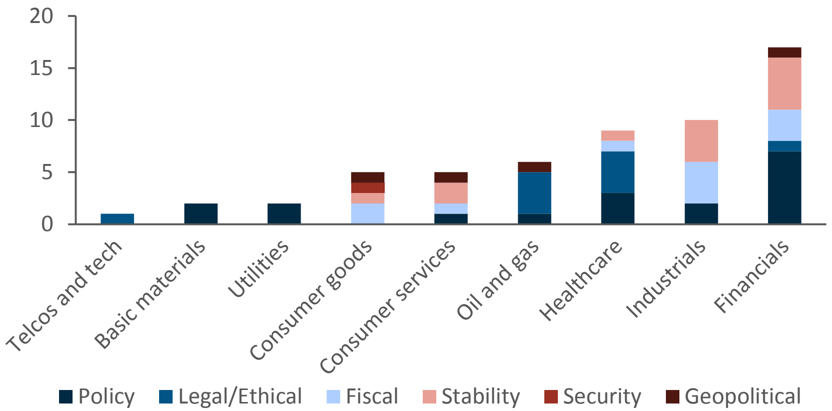
Trump aside, there is a notable concentration of other risks in the US. Fiscal risks were reported by industrial and financial firms, and a similar concentration of legal and ethical risks were reported by healthcare and oil and gas companies.

Distribution of Trump political risks, by type



Note: 21 Trump-related risks identified by 18 firms in total

Total US risks by type across sectors



Emerging markets risk: more hard than soft

Risks by geography

Emerging countries are the only group of countries where hard risks still dominate soft risks. The balance varies across sectors, with the dominance of hard risks notably higher for oil and gas firms and financials. Overall, however, the level of reporting of political risks for emerging countries is low, averaging just over one risk for every two firms.

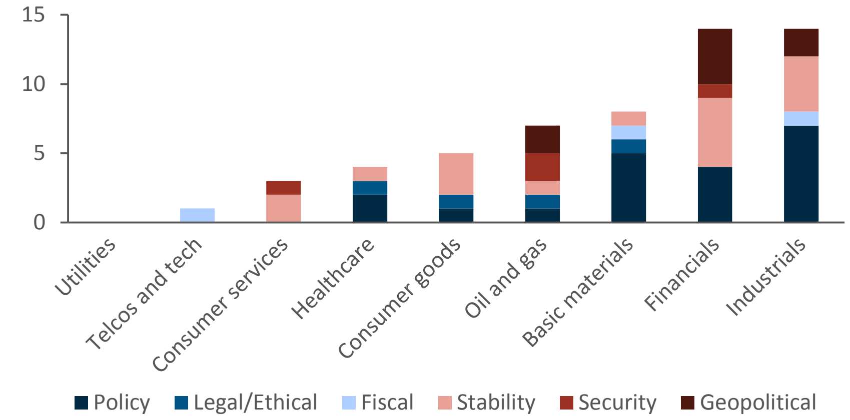
There is no single emerging country or region that dominates hard risks. But Russia, the Middle East as a region, and Middle Eastern countries are the most common sources.

Companies rarely identify specific countries where they have concerns about security or civil unrest. Where they do, these are most often in the Middle East. BP and Shell both note the risks to their operations from piracy.

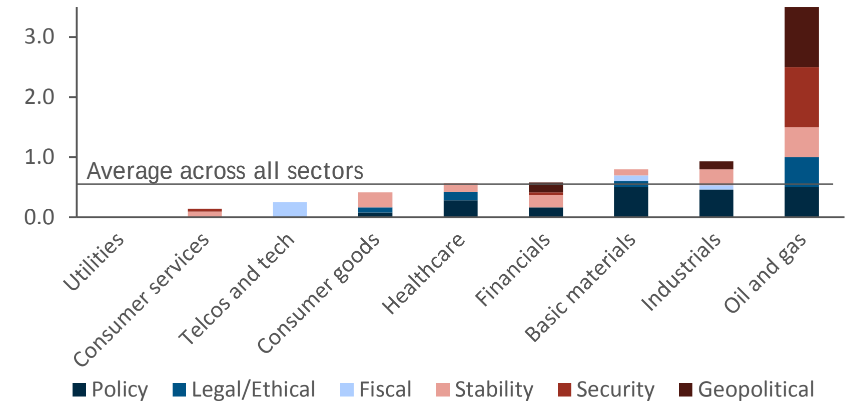
Several companies report concerns about political uncertainty in emerging countries. In the case of Fresnillo, the concern in Mexico is not so much about government, but from public sentiment turning against mining. They face the challenge of maintaining their "social license" to operate, as the public is increasingly concerned about the social and environmental consequences of mining.

Soft risks are still important in emerging countries, with 20 public policy risks identified. CRH and AstraZeneca both note risks from protectionism and foreign exchange controls. Anglo American and Shell both note risks from operating in Brazil, where difficulty obtaining the licences they need to operate is one of the problems they face.

Total EME risks by type across sectors



Average number of EME risks across sectors



Brexit risk: uncertain outlook

Risks by type

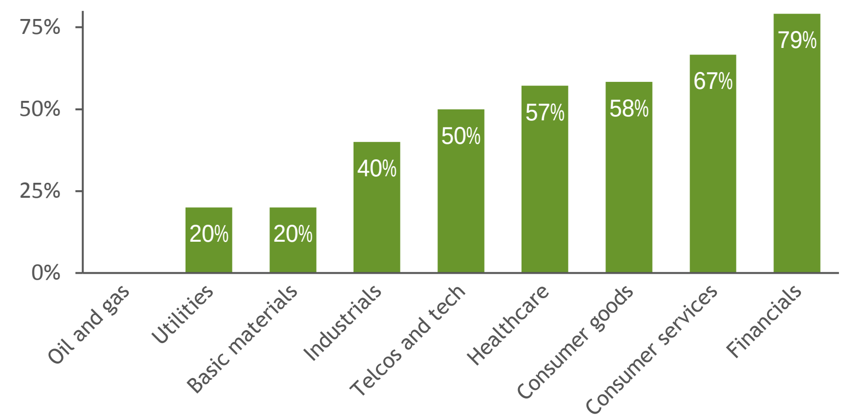
Concerns about Brexit have increased and are widespread, but far from even, and not a factor for many FTSE-100 firms. In the 2015 reporting cycle, which ended just before the referendum in June 2016, 26% of firms identified Brexit risk. This year, with a large majority of firms reporting after the referendum, this has risen to 55%. Concern from Brexit is variable. While it's a significant risk for most financials and consumer services firms, it is not for most utilities, basic materials, or oil and gas firms.

The single most frequent concern that companies have about Brexit is the uncertainty it has created. Many firms focus on this rather than more specific risks, because they judged at the time of reporting that it is too early to tell what the impact of Brexit will be. One third of firms reporting Brexit risk are concerned about the macroeconomic impact, while a quarter note the impact that Brexit has had, or may have, on currency values.

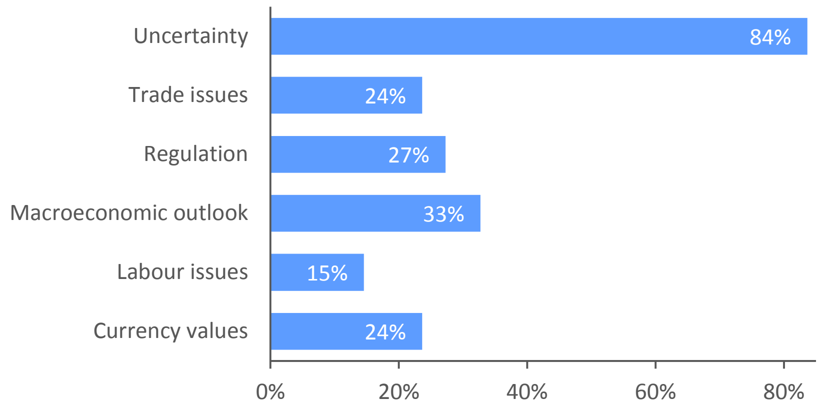
Our analysis reveals the relative importance of three specific issues that are often raised in the context of Brexit. About a quarter of firms reporting Brexit risks are concerned about market access, with this concern higher among healthcare and consumer goods firms. Burberry notes possible implications for its supply chain, while Shire notes the potential impact on the UK's ability to benefit from EU free trade agreements. Slightly more firms are concerned about the regulatory consequences, particularly among financials, but most say it is too early to tell. Concerns about labour issues are lower and noted by just 15% of firms reporting Brexit risks.

Overall, the degree of intensity of Brexit risk is highly variable. Many FTSE-100 companies observe that their wide geographic footprint means that the consequences are manageable.

The proportion of FTSE-100 companies identifying Brexit risk



The issues identified by firms reporting Brexit risk



Public policy risk

Risks by type

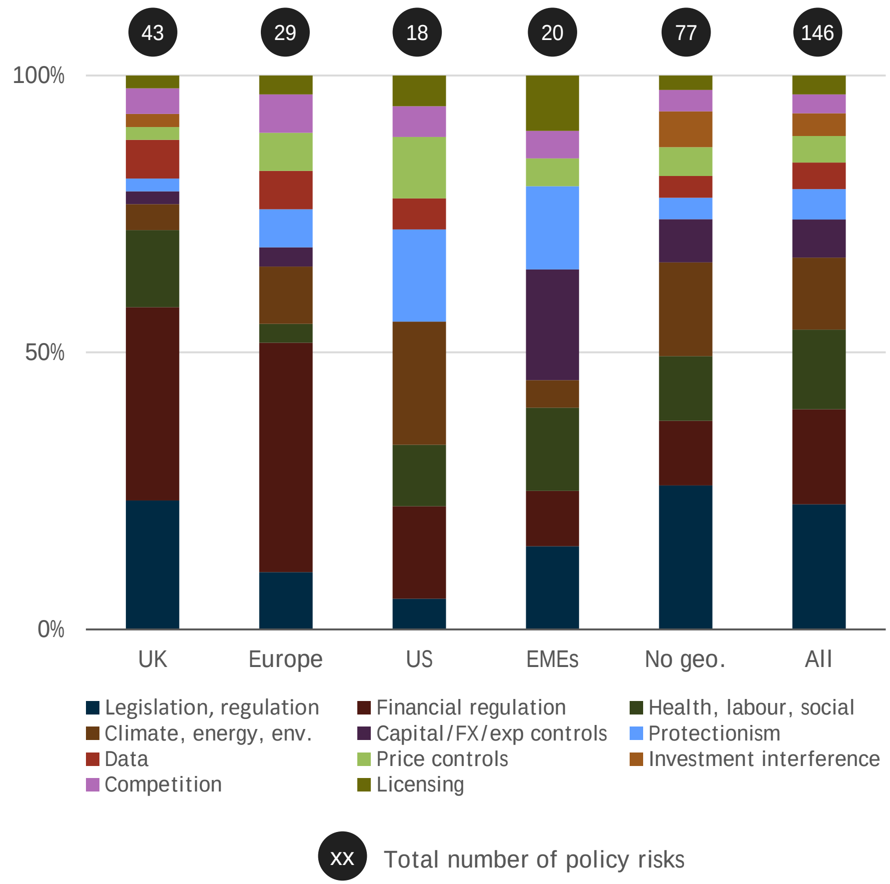
In the UK and Europe, the dominant public policy risk is financial regulation. The risks in each area are connected, as risks in the UK often concern the implementation of policies agreed at the EU level. The company reporting the most policy risks in the UK is RBS, with the bank having concerns about competition policy and investment interference, as well as about financial regulation.

In the US, there is a wider spread of policy risks, with protectionism a relatively bigger source of concern. This partly reflects uncertainty about the policies of the new Trump administration. Shire is in some ways typical, with concerns about the future of healthcare policy that are connected to the change in government, and with specific concerns about government seeking to influence prices in the healthcare sector. In the US, there is relatively less concern about financial regulation and the general environment for legislation and regulation than there is in the UK or Europe.

There are also concerns about protectionism in emerging countries. In addition, there is a relatively large proportion of risks in emerging countries regarding capital, foreign exchange or export controls. These risks are widespread and not concentrated in any particular country, or disproportionately a concern for particular FTSE-100 firms.

Reporting on emerging country policy risks is more prevalent among basic materials and industrial firms than in other sectors. The risks reported by basic materials firms are notable for their specificity. BHP Billiton, for example, identifies the risk that new labour legislation being considered in Chile could result in more operational stoppages affecting its business due to industrial action.

Distribution of policy risks across geographies



Fiscal risk

Risks by type

Fiscal policy is an important source of risk for many FTSE-100 companies. 45 identify fiscal issues in their reports, with most of them – 35 in total – identifying tax issues.

The tax issue that stands out is the potential impact of the OECD/G20 initiative on base erosion and profit shifting, known as BEPS. This work involves over 100 countries that are negotiating new rules to stop companies from exploiting gaps or inconsistencies in national tax systems to artificially shift profits to low-tax jurisdictions. This is still a work in progress, but the balance is now shifting from design to implementation.

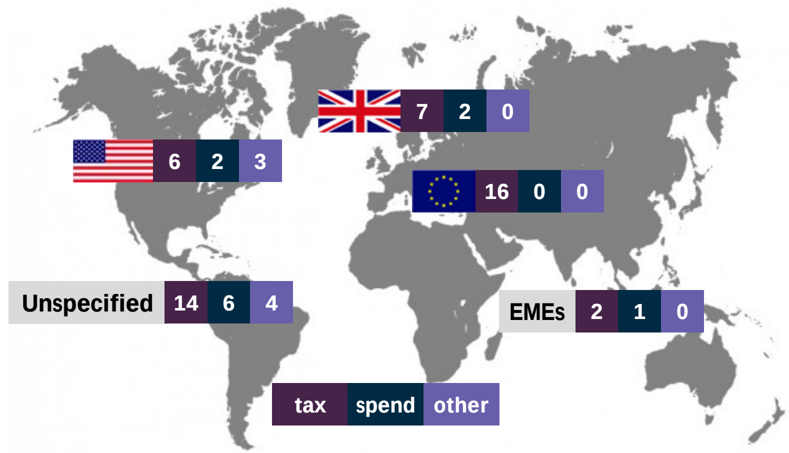
18 companies identify BEPS as a concern. This includes half of telco and tech firms, a quarter of consumer goods firms, and one fifth of firms in the industrial and consumer services sectors. In most cases, firms are concerned about uncertainty about how BEPS reforms will be implemented, with the EU and European countries the most frequently identified as a particular source for concern.

A second, related issue is state aid investigations by the European Commission. Four companies – Reckitt Benckiser, GSK, CRH and Micro Focus - identify this as a source of concern. These investigations are politically sensitive, as the Commission is now locked in legal disputes with several member states and some of the world's largest companies. The FTSE-100 companies above are not directly involved in these investigations, but note the uncertainty created for tax policies more generally.

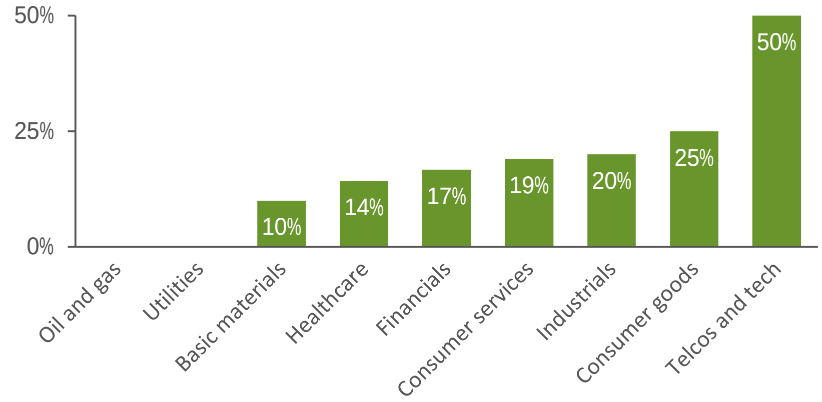
Government spending is a less common source of risk than taxation. Concerns tend to be concentrated in industrial firms that supply defence equipment, and healthcare firms whose products, including pharmaceuticals, are bought by national or local governments.

Where FTSE-100 fiscal risks are found

Number or risks where the geographic area is referenced



Share of companies identifying BEPS across sectors



Legal/Ethical risk

Risks by type

Perhaps the most ambiguous category of risk is legal and ethical risk. These fit into a grey area between political risks, and what might be regarded as routine operational risks for business.

We include these risks for several reasons. First, companies themselves often make political judgements about the behaviours or standards they deem to be appropriate. Second, where companies are subject to legal requirements over their behaviour, these are also based on political judgements by legislators that are subject to change over time. Third, enforcement of rules may be uneven and, in the extreme, some companies may find that they are singled out for political reasons.

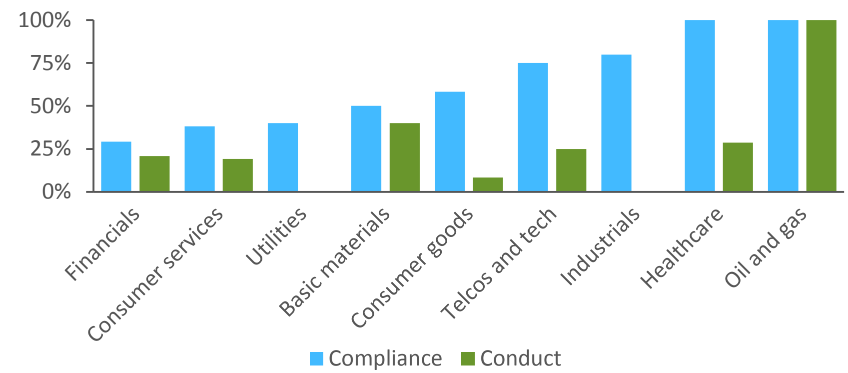
Conduct risks concern the activities of the firm, not just its legal obligations. The 17 firms that identify conduct risks are arguably among those that have the most open and realistic understanding of the ethical risks they face in different markets.

The most common exposure for firms is to bribery or corruption. Some firms, like Antofagasta, note they may be disadvantaged for refusing to make “facilitation payments”. Others note they may be exposed through their supply chains.

A handful of firms also identify the risk of modern slavery. This has been given more prominence following the introduction of the Modern Slavery Act in the UK. Associated British Foods notes that it has attempted to identify which of its supply chains may be at high risk from modern slavery.

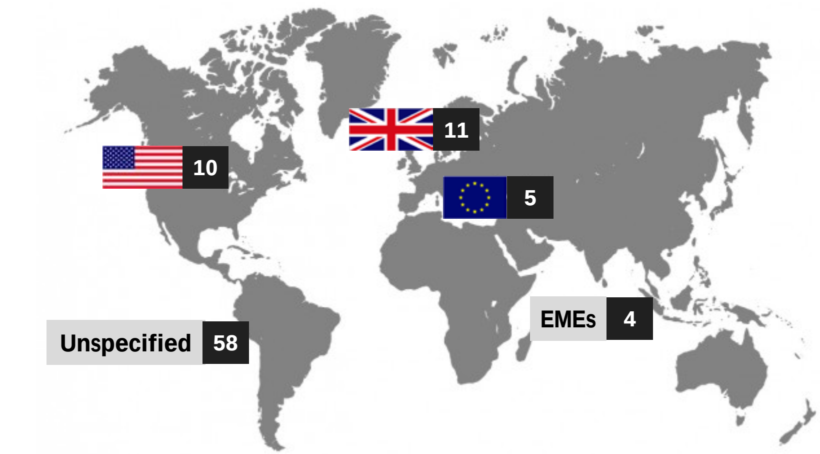
In many cases, compliance risks are pro forma, with no particular geographic source identified, but in some cases they are not. BHP Billiton notes its legal exposure from the Samarco dam failure in Brazil. Shell notes risks from the allocation of oil licenses in Nigeria.

Percent of companies reporting risks in each sector



Where compliance and conduct risks are found

Number or risks where the geographic area is referenced



Hard risk

Risks by type

The single biggest source of hard risk, which has risen substantially since last year, is political uncertainty. The number of risks reported rose from 17 to 31. The US presidential election was noted by ten firms, despite occurring only halfway through the reporting cycle. Europe or European countries (including the UK) were identified in 19 cases.

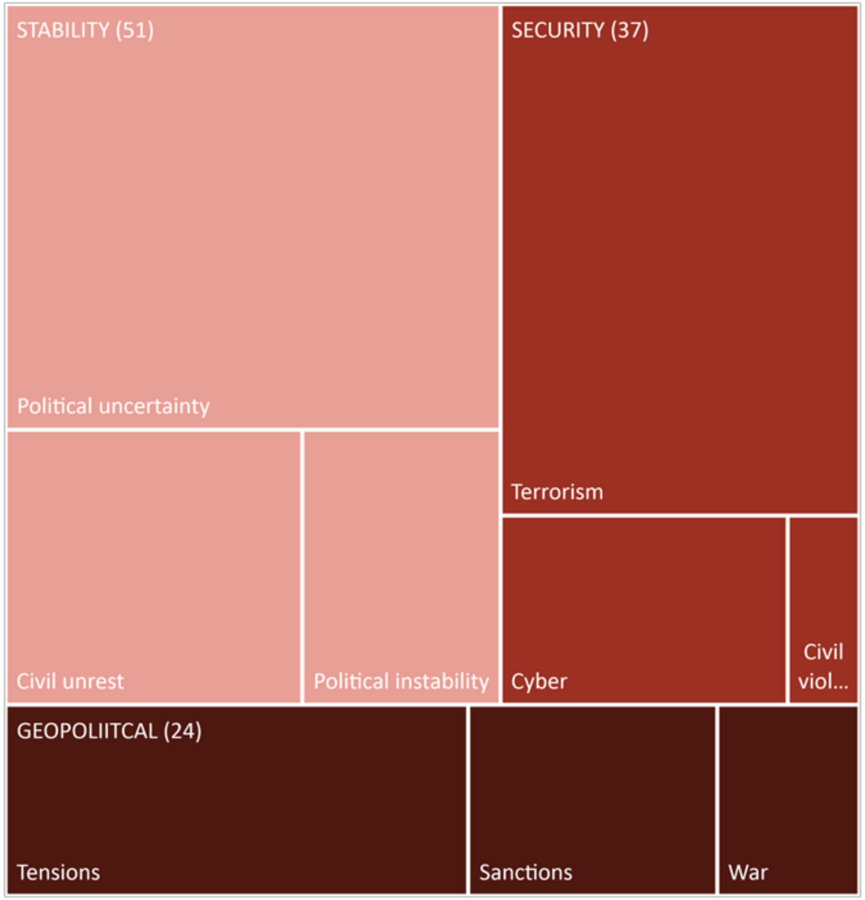
Geopolitical risks are the smallest category of hard risks, identified by just 18 firms. For some firms, these can directly impact on their business, with BP, for example, exposed to sanctions imposed on Russia by the EU and US through its stake in the state-backed oil producer Rosneft. For others, the concerns are more indirect and milder; HSBC, for example, notes the diplomatic strains between several countries where it has a presence due to territorial disputes in the South China Sea.

In our report, we only include cyber risks where there is a reference to a potential political motivation. Fewer firms reported on cyber political risks this year, despite widespread media attention to state-backed cyber activity, including potential interference in the US elections in November 2016. This may be because the risk is now seen to be more mainstream.

Most companies that identify risks from terrorism do so at a high level of generality, but with two notable exceptions. One is property firms, specifically Land Securities, Hammerson and British Land, which note the direct risk to their assets or revenues from terrorist actions. The other is travel firms, specifically TUI Group and IAG, which note the risk that terrorism could impact on their operations, even if only indirectly through the disruption it may cause.

Hard political risk map

Number of risks reported each hard risk category



Methodology

This report is based on a review of the annual reports produced by FTSE-100 companies for financial years ending in 2016. These are published in a cycle that runs roughly from May 2016 through to May 2017.

We include those companies in the FTSE-100 on 27 March 2017. We have grouped companies into sectors according to the Industry Classification Benchmark, which is also used by the FTSE-100. We have, however, merged telecommunications and technology companies into a single sector, as they have similar characteristics and include only a small number of companies. This gives us nine sectors in total.

In reviewing company reports, we focus primarily on the principle risks that the companies identify themselves, in almost all cases in a separate risk section contained in the annual report. The political risks we identify are not always labelled as principle risks. We include some that the company describes, but which it regards as not sufficiently material to be categorised as a principle risk. We also include some risks, for example several Brexit risks, which the company deems significant, but where the risk is seen as impacting on several principle risks for the business and not as a standalone risk. In many cases, we have supplemented our understanding of risks by looking at how the issues are described elsewhere in the annual report. This can provide important context or insight into how the company sees the risk impacting on its operations. In some cases, we have included risks that are not covered in the principle risks section, providing these are sufficiently specific and clearly identified as a risk elsewhere in the report.

This approach has allowed us to identify 462 political risks. It is possible that there are additional political risks that we have not identified, given our primary focus is on the principle risks as assessed by the companies. Some risks are also presented in a generic list form and we have exercised our judgement as to whether these warrant inclusion as a single risk or multiple risks, depending on the language used and the context in which they are presented in the report.

We categorise risks into seven main types and 29 sub-types. The main types are unchanged from the report we produced last year to enable comparisons. We have introduced additional sub-types this year to reflect more fully the range of risks that companies face.

Identifying and categorising political risks is more art than science. The number of risks identified partly depends on how broad or narrow is the definition that is used when assessing particular types of risk. As explained previously, we have adopted a relatively broad definition of compliance risks, including those where we judge there may be a political dimension, even if only indirectly. Compliance risks regarding bribery and corruption or modern slavery meet this test. We adopt a relatively narrow definition of cyber risks. Almost all companies report cyber risks of one kind or another, but we only include those where a link is made to political motivations, state actions or threats to critical national infrastructure. This means that the majority of cyber-crime risks reported by FTSE-100 firms are excluded from this report.

Companies are often not specific about the political risks they face, which makes it more difficult to ensure consistency in our approach across firms.

The full list of risks can be accessed from the Global Counsel website via this link.

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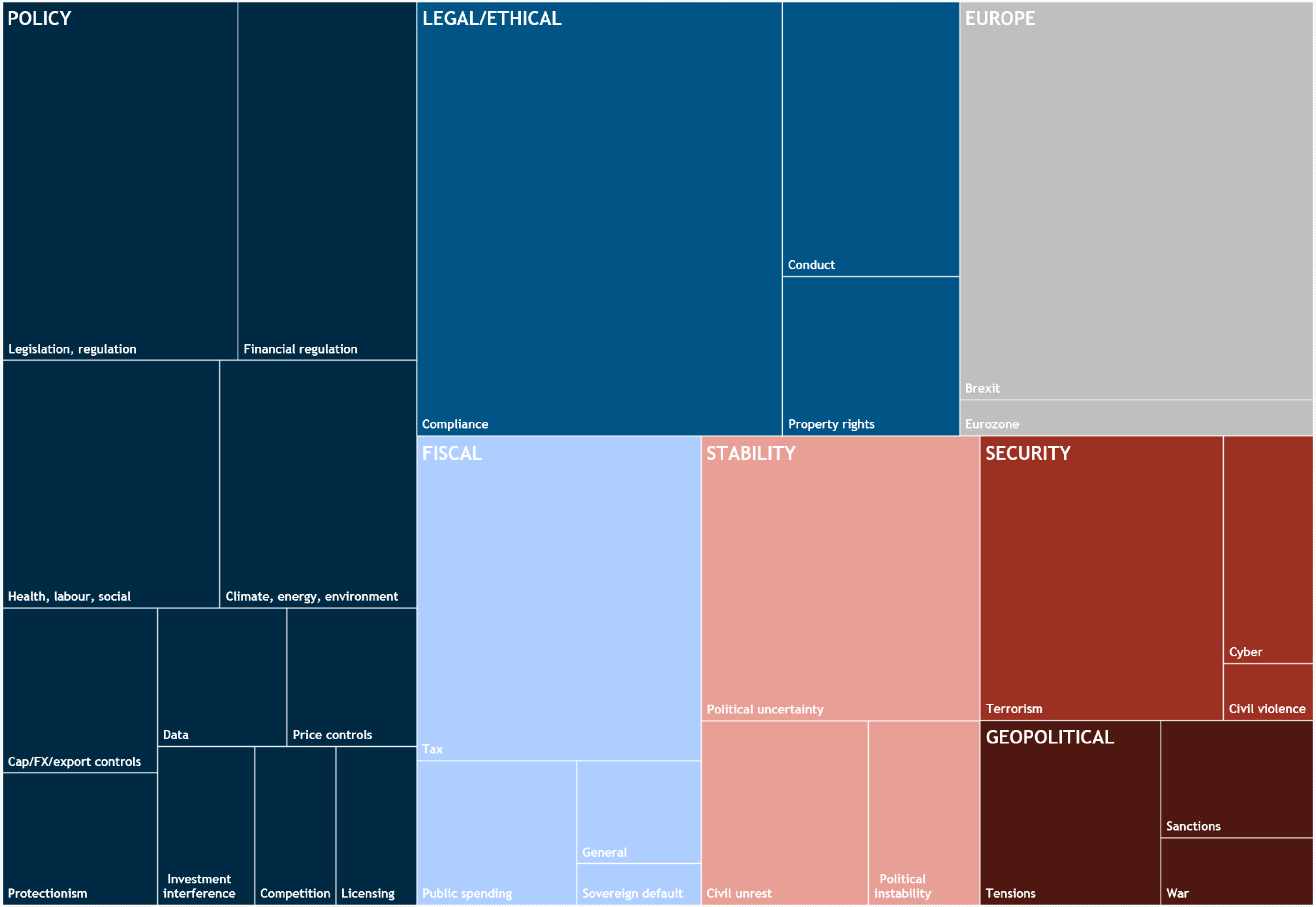
POLICY
Legislation, regulation
Financial regulation
Health, labour, social
Climate, energy, environment
Cap/FX/export controls
Data
Price controls
Protectionism
Investment interference
Competition
Licensing
LEGAL/ETHICAL
Compliance
Conduct
Property rights
EUROPE
Brexit
Eurozone
FISCAL
Tax
Public spending
General
Sovereign default
STABILITY
Political uncertainty
Civil unrest
Political instability
SECURITY
Terrorism
Cyber
Civil violence
GEOPOLITICAL
Tensions
Sanctions
War