



# Embedding & Deriving Value from an Effective Risk Culture

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# What is risk culture

“Risk culture can be defined as individual and group **behaviour** within an organization that **determines** the way in which the company **identifies, understands, discusses** and **acts** on the risks the organization confronts and takes.”

Source: “Reform in the Financial Services Industry: Strengthening Practices for a More Stable System.” Institute of International Finance, 2009

*Although there are some universal aspects of risk culture, it varies between organisations, in keeping with business strategy, markets, maturity etc.*

# Risk culture failures

**Insurance bosses jailed for fraud**

A former insurance chief has been jailed for seven years after being convicted of defrauding investors.

Michael Bright, 63, was in charge of Independent Insurance when it collapsed in 2001 in one of the industry's most high-profile insolvencies.

Finance director Dennis Lomas received a four-year sentence. Deputy manager Philip Condon was given three years.

A jury had heard how the trio masked the firm's financial problems by withholding details of claims.

**Probe**

About 1,000 jobs which had previously been advertised by the firm's closure.

The SFO said it had received £22m profit from the sale of the firm's assets.



## MailOnline

### Lloyds caught up in ANOTHER scandal: Call centre workers told to 'play the system' and mislead customers who were complaining about PPI mis-selling

- Workers told to ignore potential fraud and fake information on loan sales
- Secret document reveals that customer evidence has been lost
- Call centre operated on the basis that PPI was never mis-sold
- Lloyds Banking Group suspended its contract with Deloitte over the matter
- Scandal was revealed by an undercover reporter working at the call centre

By RICHARD HARTLEY-PARKINSON

PUBLISHED: 09:47, 11 June 2013 | UPDATED: 14:04, 11 June 2013

**J.P. Morgan Unit Shifts Operations**

The unit will cut 12 jobs in its share-down.

Some 16 million shares of the unit were sold last week at a price of \$3.26 to make the unit more attractive to investors.

Each unit was sold for \$3.26 to make the unit more attractive to investors.

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**J.P. Morgan's \$2 Billion Blunder**

Losses on Massive Trading Bet Gone Wrong; Dimon's Mea Culpa

Comment | Culture | Business | Money | Life & Style

Under new pressure as 'rogue' trader loses \$2bn

Robert J. M. Smith, a UBS investment bank trader remains in police custody on allegations that he cost the Swiss bank £1.2bn

Thursday 18 September 2011 21:20 BST

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Credit cards & loans

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**PPI bill for banks expected to hit £9bn**

By SEAN POLTER

Last updated at 8:21 AM on 10th May 2011

Millions of given refunds. Banks resist. City watchdog. Boss who we insure. The bill will cut 12 jobs in its share-down. Some 16 million shares of the unit were sold last week at a price of \$3.26 to make the unit more attractive to investors. Each unit was sold for \$3.26 to make the unit more attractive to investors. Each unit was sold for \$3.26 to make the unit more attractive to investors.

**RBS secures takeover of ABN Amro**

A consortium led by the Royal Bank of Scotland has won the battle to buy the Dutch bank ABN Amro.

About 86% of ABN Amro's shareholders have accepted a 71bn euro (\$98.5bn; £49bn) offer to clinch Europe's biggest ever banking takeover.

The RBS consortium, which also includes Dutch bank Fortis and Spain's Santander, is now expected to break up the Dutch lender.

**Barclays: FSA regulator criticises 'culture of gaming'**

A senior banking regulator has told MPs Barclays had a "culture of gaming" that emanated "from the top".

The Financial Services Authority's Andrew Bailey also said former Barclays chief executive Bob Diamond's recent evidence to MPs was "highly selective".

Earlier, ex-Barclays executive Jerry del Missier told MPs he was instructed by Mr Diamond to manipulate the bank's Libor interest rate submissions.

Barclays has been fined £290m after admitting to the "culture of gaming".

**Boss of 'Australian Enron' jailed**

Raymond Williams, the former boss of insurance firm HIH, has been jailed for four-and-a-half years for his part in Australia's biggest corporate collapse.

Dubbed Australia's Enron, HIH went bust in 2001 with debts of A\$5.3bn (£2.1bn; \$4.1bn).

Nine former executives were charged over the scandal and Williams, known for big spending, admitted misleading and reckless corporate behaviour.

Williams's lawyers will appeal against the "manifestly excessive" sentence.

**Nationwide**

The scandal affected tens of thousands of policy holders across the country.

**The AIG Bailout Scandal**

As Elizabeth Warren's devastating Congressional report Reserve used taxpayer money to bail out the insurance giant, the major banks to clean up the mess they helped create.

William Greider August 6, 2009

The government's \$182 billion bailout of insurance giant AIG should be a lesson for understanding the financial crisis and its costly aftermath. International Group explains the larger catastrophe not because this bailout in history but because AIG's collapse and subsequent rescue were critical elements, including delusion and deception. These financial elements, but this account focuses on something more mortals can understand: confusion in high places, and the failure of governing institutions to protect the public.

*"Most institutions have a set of values to which they ascribe however, in many cases there is clearly a gap between what they claim to believe and do, and what they actually do. These values also tend not to be aligned or lived by the employees meaning the firm does not practice what it preaches..."* H. Sants, FSA CEO, 17th June 2010

# Why is risk culture important – industry view

## 2012 ERM Survey – Key Findings

Risk culture is important to the ERM end-state vision...

...and is already a major contributor to business performance...

...but the journey is continuing...

...with challenges to be overcome...

- 80% of respondents indicated that risk culture is a highly important part of their end-state vision of ERM
- Risk culture has enhanced business performance over the last two years according to 68% of respondents
- Significant further development of risk culture is planned over the next two years
- Aligning performance management and incentive remuneration with key risk metrics, remain a challenge

***“Culture, more than rule books, determines how an organisation behaves”  
Warren Buffet, Berkshire Hathaway***

# In Europe, Solvency II and CRD III have set the high-level standards that national regulators will build from

**PRA:** The UK PRA's October 2012 report on approach to risk management covers embedding culture, board expertise and models.

Governing bodies will be expected to embed and maintain a firm-wide culture that supports safety and soundness, and that is consistent with protecting the interests of policyholders .

**ACP:** France's review of supervisory practice in the financial services sector concluded that it is generally aligned with FSB standards on remuneration (La Revue, December 2011).

Solvency II governance requirements are being transposed into French law.

**DNB:** The March 2013 report Leading by Example observes that both executive and supervisory board members do not consciously steer on the more human aspects, which are key factors for being successful and effective for the organisations.

A Dutch survey in December 2011 explored organisational psychology as a means of improving corporate culture and organisational behaviour in the context of financial supervision.

**BaFin:** Presented a revised version of MaRisk (the framework for risk management in the banking sector) in December 2012, transposing international regulatory requirements into supervisory practice.

Insurance supervisor requirements in regards to risk management are based on Germany's MaRisk VA 2009 Circular.

**Solvency II:** Incentives should not encourage inappropriate risk taking  
**Capital Requirements Directive (CRD) III:** Compensation programmes for Boards and material risk takers will need to take account of risk assessments within a strong pay and performance management governance structure

# Several national developments have taken place around the world as global standards have been reviewed and revised

**OSFI (Canada):** September 2012 Life Insurance Regulatory Framework paper. The degree of development on the issues discussed varies; for many issues the consultative process has not yet been completed or, in some cases, even begun.

Over the past several years, Canadian life insurance companies have made significant progress in their governance and oversight processes to better identify, measure, manage and price their risk-taking activities.

**CIRC (China):** November 2010 guidelines on Implementation of Enterprise Risk Management for Life, Health and Pensions Insurers covers risk governance, risk measurement, risk management and risk culture developments.

All Chinese companies must develop a risk culture that ensures all staff are constantly aware of risk factors associated with work and how staff can influence them.

**NAIC (USA):** March 2013 Manual provides guidance to an insurer (entity and/or group) with regard to reporting on its Own Risk and Solvency Assessment (ORSA)

Governance structure should clearly define and articulate roles, responsibilities and accountabilities; and a risk culture that supports accountability in risk-based decision making.

**APRA (Australia):** May 2013 Prudential Standard sets out the requirements for a companies regulated in Australia to maintain a risk management framework and strategy.

It is the duty of the Board to ensure a sound risk management culture is established and maintained throughout the institution;

**Financial Stability Board (FSB):** Thematic review on risk governance (February 2013)  
**Insurance Core Principles (ICPs) ICP16:** ERM for Solvency Purposes; **ICP7:** Board oversight over remuneration (October 2012)  
**IAIS ComFrame:** Module 2 Group-wide ERM and remuneration policy (July 2012 – draft)

# How risk culture can add value in insurance

<b>Effective decision-making</b>	<ul style="list-style-type: none"><li>• Risk culture is critical to effective business decision-making and performance across key activities such as business strategy and planning; pricing and underwriting; and asset management, to help identify and exploit opportunities as well as manage down-side risk</li></ul>
<b>Improved value from risk models</b>	<ul style="list-style-type: none"><li>• Risk models do not provide certainty of outcome and to be used effectively for business decision-making or capital setting requires a high degree of understanding and confidence to challenge results. This relies on an effective risk culture, which also guards against the risk of 'gaming' the model</li></ul>
<b>Lower cost of risk governance</b>	<ul style="list-style-type: none"><li>• Risk culture and governance frameworks are closely linked. Insurers have commonly implemented 3 lines of defence models and a control framework. These controls can unintentionally stifle creativity and be overly onerous but if the business is confident that the risk culture across the organisation is appropriate a lighter touch regime may be possible</li></ul>
<b>Good regulatory relationships</b>	<ul style="list-style-type: none"><li>• Regulators are increasingly concerned with risk culture and making judgements based on individual and collective understanding and attitudes in insurers based on interviews, as well as effectiveness of processes and controls. A good risk culture can help provide confidence as well as reducing the risk of regulatory fines</li></ul>
<b>Sustainable business performance</b>	<ul style="list-style-type: none"><li>• Sustaining long term business performance requires a good understanding of risk together with consistency of attitudes and behaviours over time to enable the insurer to act effectively, achieving the desired balance between risk and reward and get the big calls 'right'</li></ul>

# Risk culture is an important enabler in a risk framework

*Risk culture is at the heart of an integrated risk framework*



Risk models, risk governance structures and processes are only part of the story...to achieve improved business performance, everyone in the organisation must have the right attitudes and behaviours towards risk

## Core characteristics of a good risk culture

- ✓ Senior management setting up key values & principles and demonstrating these through their actions
- ✓ Everyone in the organisation has ownership and responsibility for doing the 'right thing'
- ✓ Issues are openly escalated
- ✓ Open communication across the company
- ✓ Effective and transparent risk-based decision making processes
- ✓ Clear risk policies & processes that support the understanding of expected attitudes & behaviours
- ✓ Performance management, employee development and reward programmes that promote and reinforce the right values & behaviours

...understanding of behaviours, beliefs and relationships

# Risk Culture can be influenced by a number of 'levers'



The background of the slide is a complex, abstract geometric pattern consisting of numerous thin, white lines that intersect to form a variety of irregular, multi-sided polygons. The lines are distributed across the entire gray background, creating a dense, interconnected network of shapes. In the upper-left quadrant, there is a solid orange horizontal bar. The word "Challenges" is written in white, bold, sans-serif font within this bar.

# Challenges

# Questions insurers should be asking...

## Board

- Does the Board have a clear view of the risk culture and has this been communicated consistently across the firm?
- Are the business strategy and risk strategy aligned sufficiently to inform behaviours and decision-making across the organisation?
- How does the business develop, sustain and demonstrate an appropriate risk culture that supports the strategic objectives and risk appetite?
- How do you ensure that business decision-making takes appropriate account of risk issues?

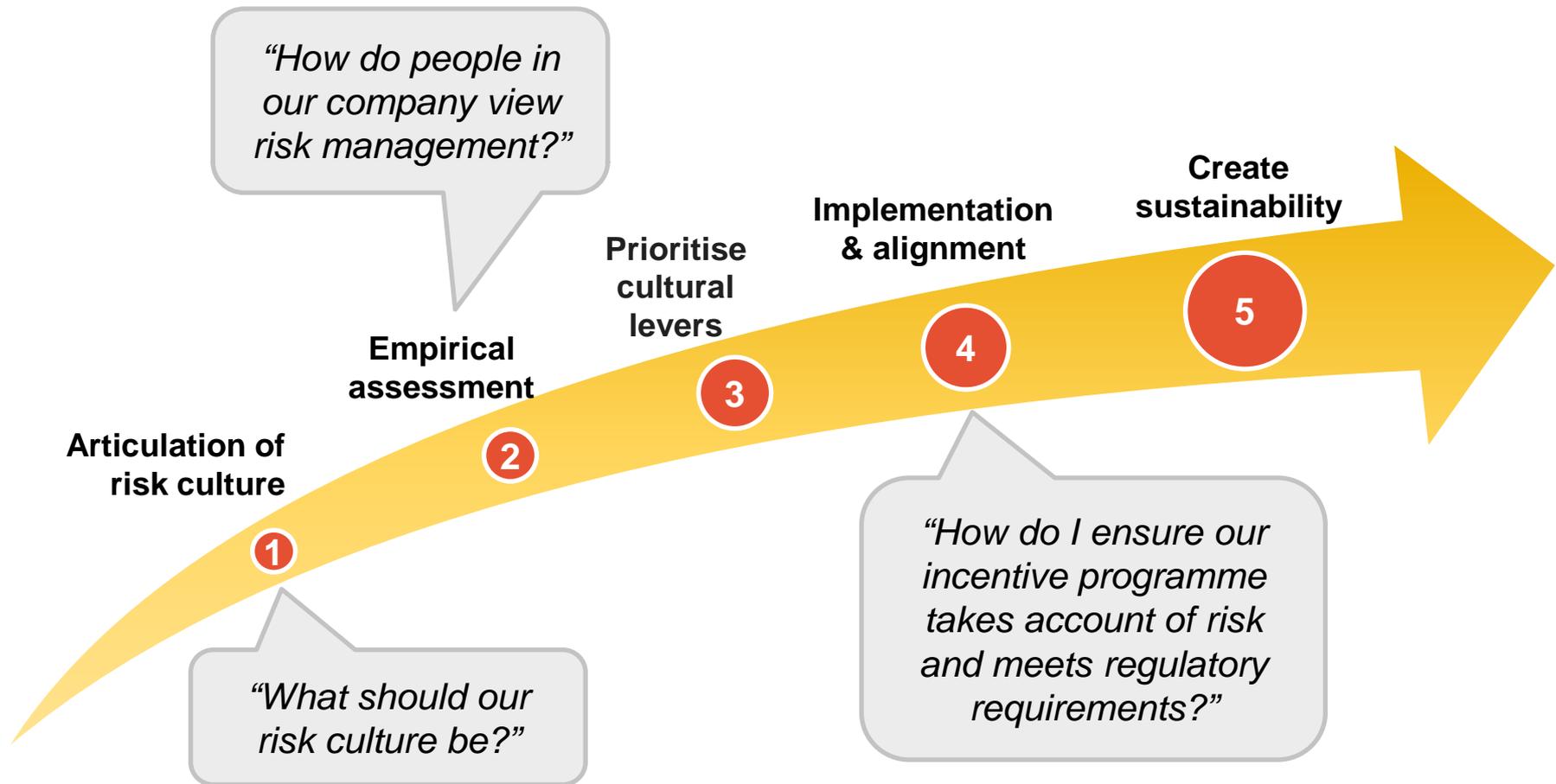
## Risk

- How is the Risk Function perceived by the board, management and others in the business?
- How well do people throughout the business understand their own responsibilities around risk?
- How do we ensure risk and risk metrics are understood and acted upon across the organisation?
- Does the current risk management framework promote and reinforce desired attitudes and behaviours?

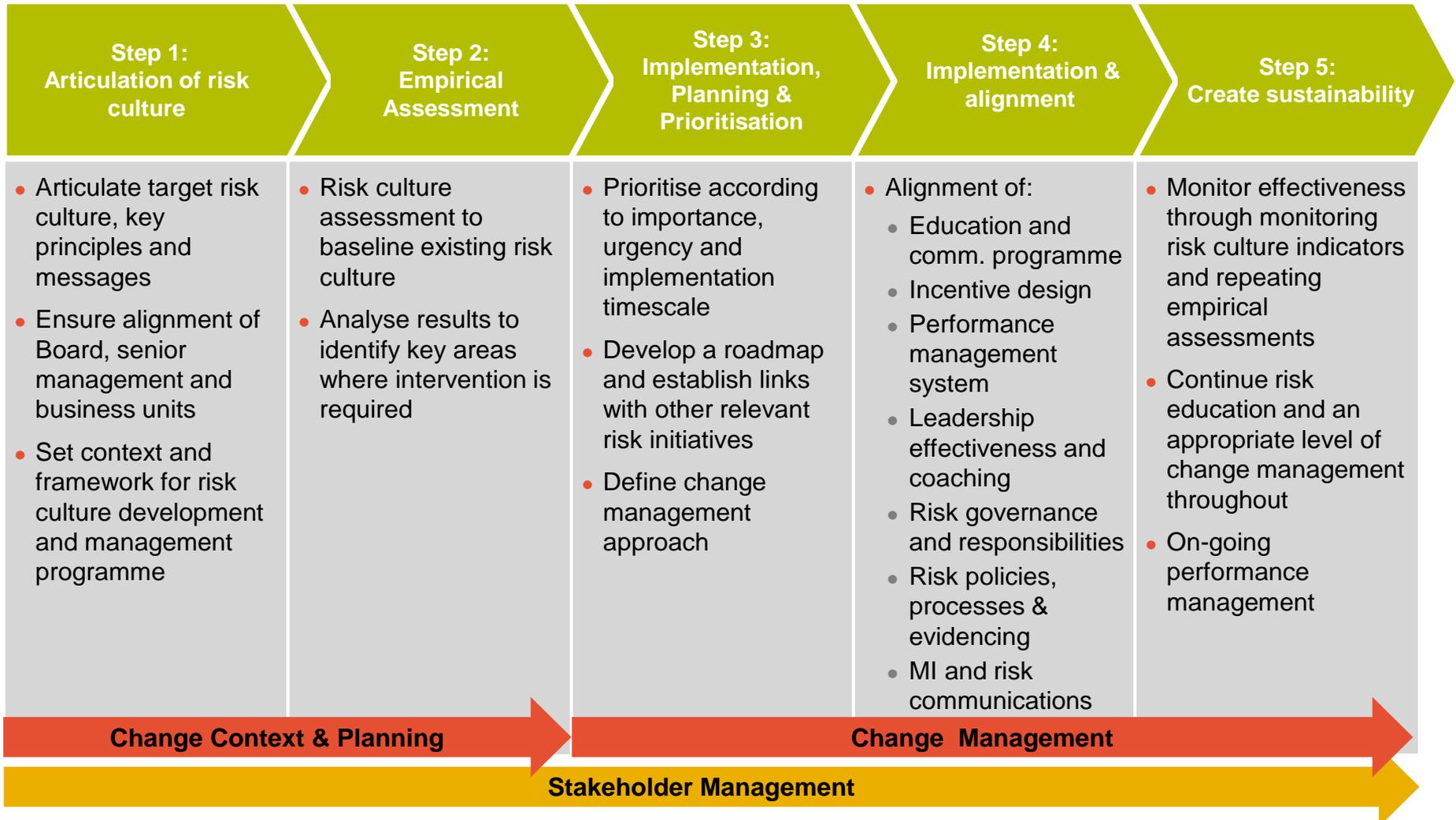
## HR

- Do risk management objectives form part of the performance management process? How is progress monitored & measured?
- Is there alignment between personal objectives and corporate risk objectives?
- How do we ensure that our pay and incentives programme takes account of risk and meets regulatory requirements?
- How well does our learning & development programme promote and support our risk culture objectives?
- How do we create the right conditions to engender and sustain the required change of risk culture?

# Different companies will have different entry points into the process — the steps do not necessarily need to be consecutive



# A comprehensive process to embed risk culture across the organisation

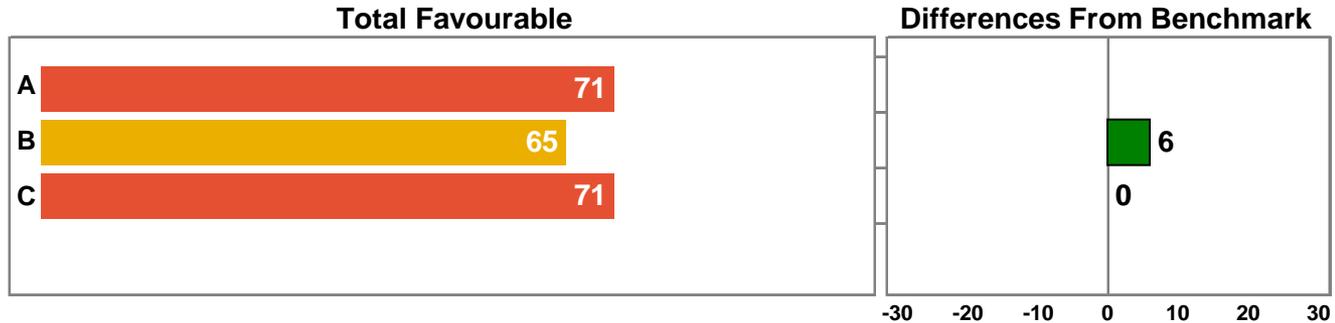


# Typical coverage of a risk culture survey questionnaire

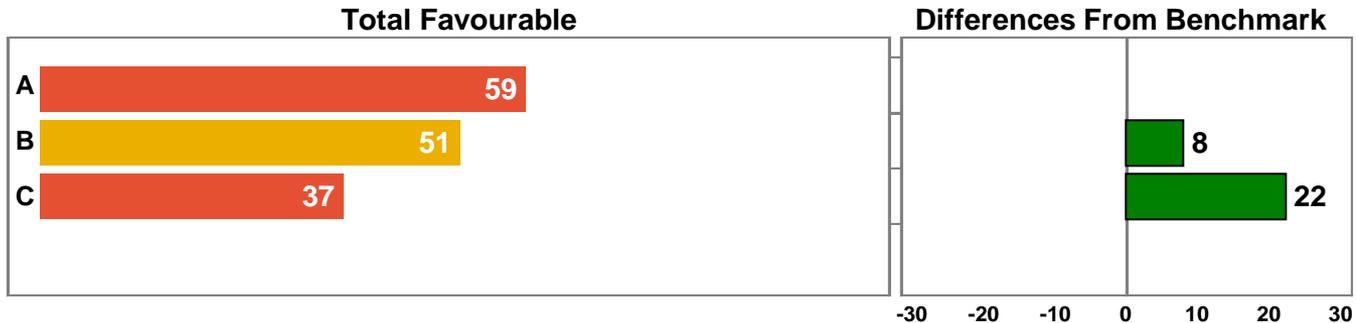
Category	Coverage
Leadership Commitment	Leadership throughout the organisation has a focus on risk appropriate decision-making and behaviour
Communication	Employees feel enabled to raise issues or concerns and feel informed about risk management
Teamwork/Collaboration	Teamwork is encouraged through open opinions and trust
Resourcing	Sufficient resources are available to ensure quality
Rewarding Appropriate Behaviour	Performance management appropriately rewards appropriate risk taking
Risk Controls	Risk controls and process are appropriate, clear, timely and effective
Risk Orientation	The company's attitude towards risk is clear and appropriate
Local Level	Local Level Leaders support an environment and act appropriately in regards to risk management

# High level of confidence in the design of recent changes

31. Management provides a clear sense of direction in relation to risk management.



49a. Over the past year or so, changes to the way we manage risk have: Been well designed



- A. XYZ OVERALL 2010 (202)
- B. TOWERS WATSON NATIONAL NORM (25482)
- C. TOWERS WATSON GLOBAL FINANCIAL SERVICES COMPANIES NORM (159464)

## What risk culture surveys can deliver

**Carrying out such a survey yields invaluable insights, facilitating the active management of a company's risk culture. It also enables:**

1. Setting the tone from the top
2. Engaging with external stakeholders
3. Creating an internal dialogue
4. Better informed business decisions



## Questions?

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