Embedding & Deriving Value from an Effective Risk Culture

Paul Caputo

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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.”


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

**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)

**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;
## How risk culture can add value in insurance

### Effective decision-making
- 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.

### Improved value from risk models
- 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.

### Lower cost of risk governance
- 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.

### Good regulatory relationships
- 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.

### Sustainable business performance
- 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’.
Risk culture is an important enabler in a risk framework

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

**Impact**
- How risk impacts the management of the business
- Regular feedback loop to the risk strategy as understanding about how risk impacts the business increases

**Enablers**
- These elements need to be in place to make an effective link between the risk strategy and the successful use of risk in managing the business
- Each of these enablers is important for different reasons and each needs to be in place

**Foundation**
- Starting point to build an ERM framework
- Articulates company’s attitude and strategy around risk

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’
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.

1. Articulation of risk culture
   - “What should our risk culture be?”

2. Empirical assessment
   - “How do people in our company view risk management?”

3. Prioritise cultural levers

4. Implementation & alignment
   - “How do I ensure our incentive programme takes account of risk and meets regulatory requirements?”

5. Create sustainability
A comprehensive process to embed risk culture across the organisation

<table>
<thead>
<tr>
<th>Step 1: Articulation of risk culture</th>
<th>Step 2: Empirical Assessment</th>
<th>Step 3: Implementation, Planning &amp; Prioritisation</th>
<th>Step 4: Implementation &amp; alignment</th>
<th>Step 5: Create sustainability</th>
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<tbody>
<tr>
<td>Articulate target risk culture, key principles and messages</td>
<td>Risk culture assessment to baseline existing risk culture</td>
<td>Prioritise according to importance, urgency and implementation timescale</td>
<td>Alignment of:</td>
<td>Monitor effectiveness through monitoring risk culture indicators and repeating empirical assessments</td>
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<td>Ensure alignment of Board, senior management and business units</td>
<td>Analyse results to identify key areas where intervention is required</td>
<td>Develop a roadmap and establish links with other relevant risk initiatives</td>
<td>• Education and comm. programme</td>
<td>Continue risk education and an appropriate level of change management throughout</td>
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<td>Set context and framework for risk culture development and management programme</td>
<td>Define change management approach</td>
<td>• Incentive design</td>
<td>• Performance management system</td>
<td>On-going performance management</td>
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Change Context & Planning

Change Management

Stakeholder Management
## Typical coverage of a risk culture survey questionnaire

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

Example

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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?

Paul Caputo
paul.caputo@towerswatson.com
02 8198 9055