

Risk culture

- what is it and how to embed it throughout the organisation?

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Risk Leaders' Conference

19 November 2010

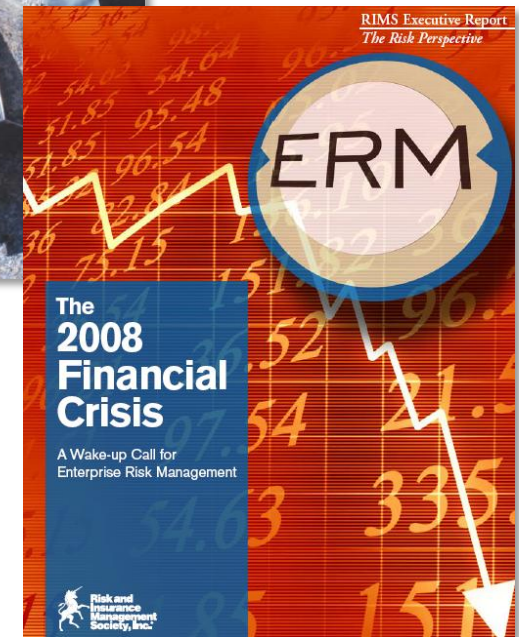
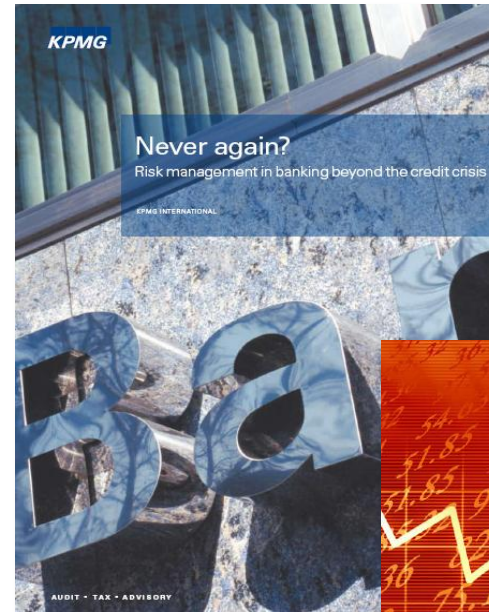


Risk culture and the credit crunch

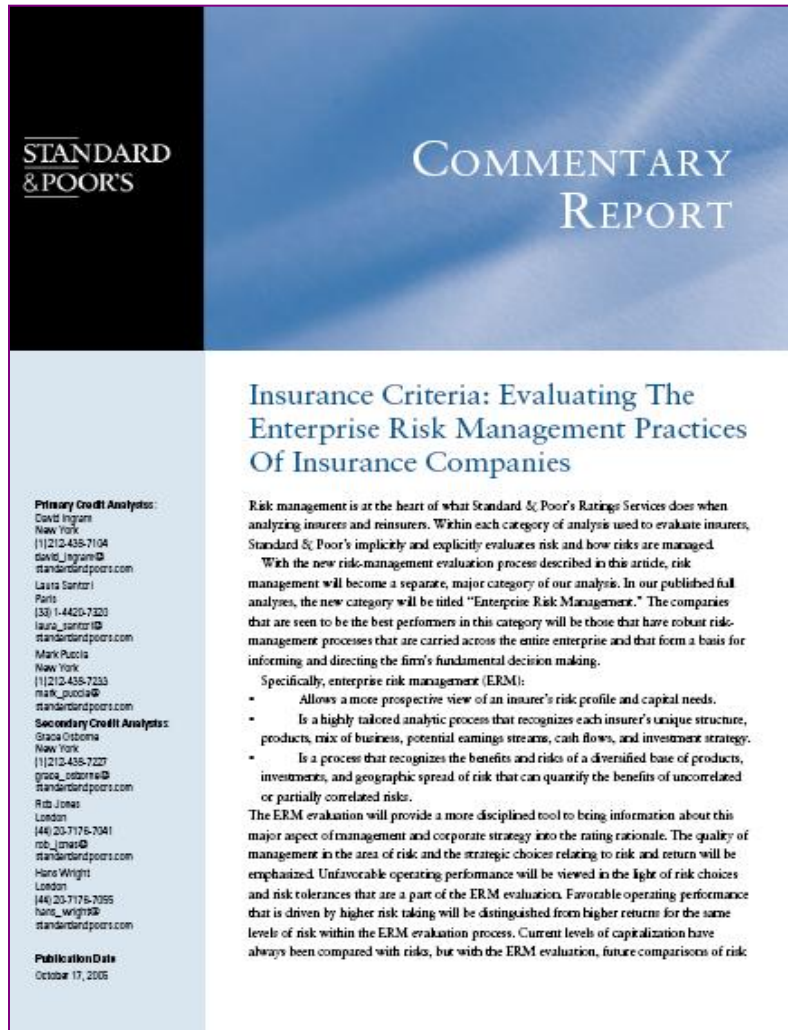
“They should have confidence in their risk **culture** and the **courage** to be able to say: Although we making lots of money here, additional risk will not result in additional value being added to the business in the long term.”

“But it also requires a certain degree of **courage** in cases where a company’s **culture** is not yet ready to embrace ERM fully. As Chris Duncan said, “... for ERM to be effective, occasionally one does have to swim against the tide and run the risk of getting eaten by the sharks.”

Available from IRM Online Resource Centre (ORC)



Rating agency response



STANDARD & POOR'S

COMMENTARY REPORT

Insurance Criteria: Evaluating The Enterprise Risk Management Practices Of Insurance Companies

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Risk management is at the heart of what Standard & Poor's Ratings Services does when analyzing insurers and reinsurers. Within each category of analysis used to evaluate insurers, Standard & Poor's implicitly and explicitly evaluates risk and how risks are managed.

With the new risk-management evaluation process described in this article, risk management will become a separate, major category of our analysis. In our published full analyses, the new category will be titled "Enterprise Risk Management." The companies that are seen to be the best performers in this category will be those that have robust risk-management processes that are carried across the entire enterprise and that form a basis for informing and directing the firm's fundamental decision making.

Specifically, enterprise risk management (ERM):

- Allows a more prospective view of an insurer's risk profile and capital needs.
- Is a highly tailored analytic process that recognizes each insurer's unique structure, products, mix of business, potential earnings streams, cash flows, and investment strategy.
- Is a process that recognizes the benefits and risks of a diversified base of products, investments, and geographic spread of risk that can quantify the benefits of uncorrelated or partially correlated risks.

The ERM evaluation will provide a more disciplined tool to bring information about this major aspect of management and corporate strategy into the rating rationale. The quality of management in the area of risk and the strategic choices relating to risk and return will be emphasized. Unfavorable operating performance will be viewed in the light of risk choices and risk tolerances that are a part of the ERM evaluation. Favorable operating performance that is driven by higher risk taking will be distinguished from higher returns for the same levels of risk within the ERM evaluation process. Current levels of capitalization have always been compared with risks, but with the ERM evaluation, future comparisons of risk

- Rating agencies increasingly set the ERM agenda in Financial Services
- S&P provide a separate ERM Rating focusing on:

Risk culture

Risk control practices

Emerging risks

Strategic risk management

Why is risk culture difficult?

“Employees are charged with conducting their business affairs in accordance with the highest ethical standards. An employee shall not conduct himself or herself in a manner which directly or indirectly would be detrimental to the best interests of the company or in a manner which would bring to the employee financial gain separately derived as a direct consequence of his or employment with the company”

*Enron Code of Ethics
July 2000*

Anyone can write a Code of Ethics...

Getting it wrong can be painful...



The Arthur Andersen partner was on his cell phone when he said,

"Ship the Enron documents to the feds,"

but his Secretary heard,

"Rip the Enron documents to shreds."

It turns out that it was all just a case of bad cellular.

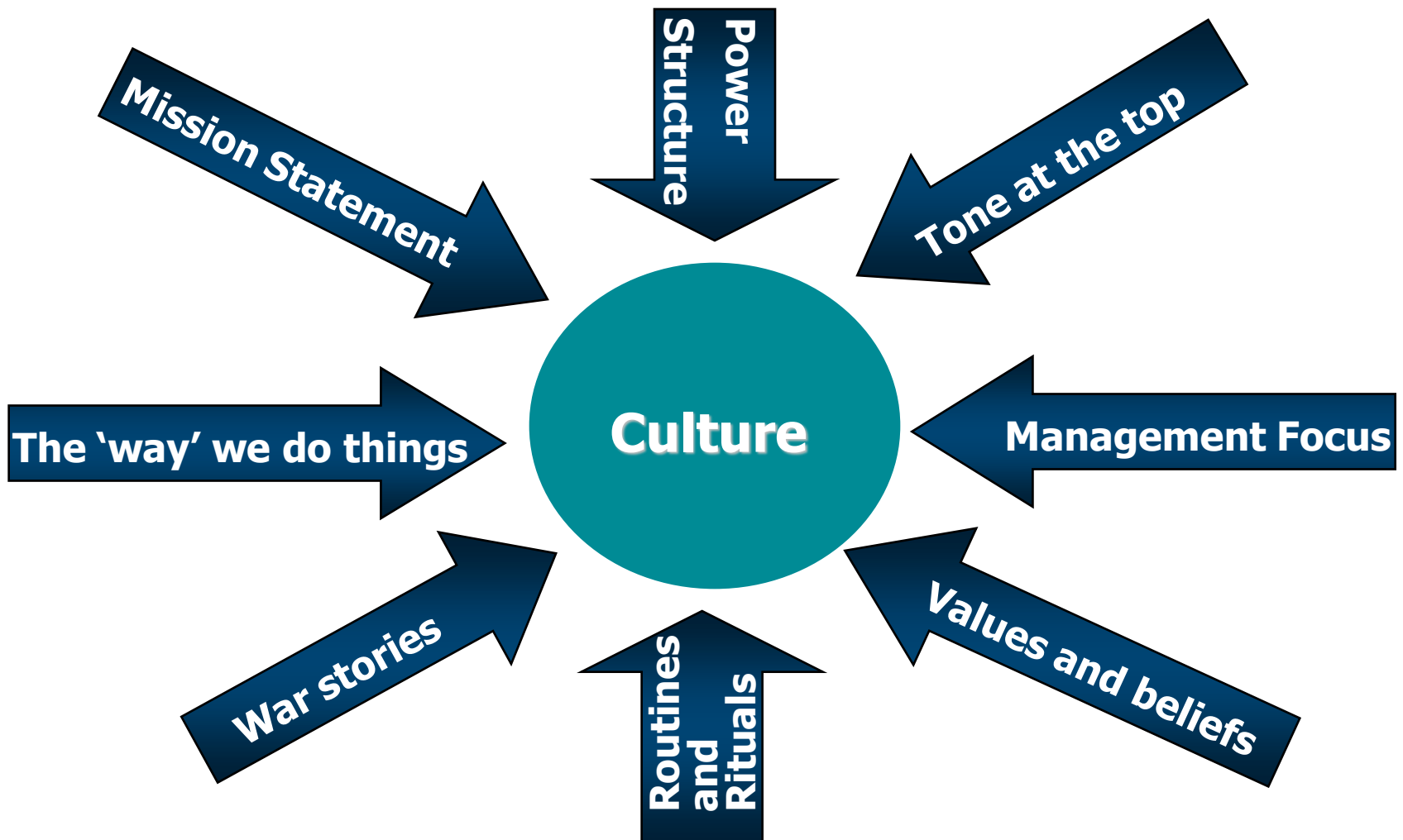


Sprint PCS The clear alternative to cellularSM

Define a risk management culture?

- A set of rules?
- A common language?
- A business process?
- Effective tools?
- A set of shared values?
- A common perspective ?
- Consistent behaviours?

A culture is complex



How is culture manifested?

Risk culture is seen through the prism of Behaviours, specifically risk-taking behaviours

Risk appetite governs how risk taking is perceived, governed and rewarded



Managed Attitudes ⇒ **Modified Behaviour** ⇒ **Changed Culture**

Linking risk competence to values?

“**Culture** is about how principles are learned and translated in day-to-day behaviour. **Values** contribute to the culture and may include *integrity, customer focus and results.*”

Council for Competitiveness (2008)

Typical organisational values might also include:

Integrity - Doing the right thing, trust

Courage - Facing the truth and acting decisively

Empathy - Listening, showing respect, showing we care

Motivation - Aiming higher and delivering

Diversity - Celebrating difference

Teamwork - Working together

How is risk competence and awareness **integrated** into such a values framework?

Culture is about shared meanings...

Common Governance Spirit

Widely held system of shared meanings

Rules are adhered to

Systems of Control

Strong pressure to conform to a shared system of meanings

- Rules are set to guide behaviour -

Independence

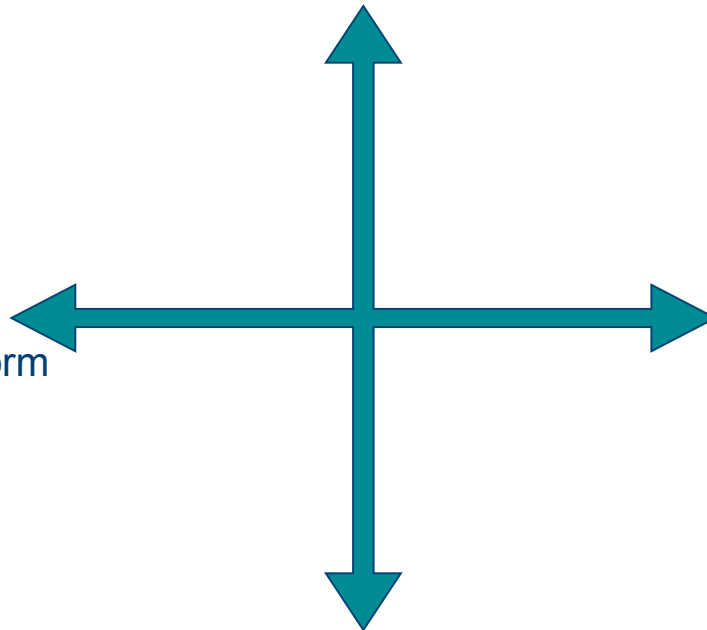
Increasingly independent of other people's pressure to conform

- Staff are left to be guided by their own values -

Weak Governance Spirit

Private system of meanings

Rules are not implemented



Risk culture diagnostic

Tone at the Top

- Risk leadership
- Responding to bad news

Governance

- Risk governance
- Risk transparency

Competency

- Risk resources
- Risk competence

Decision Making

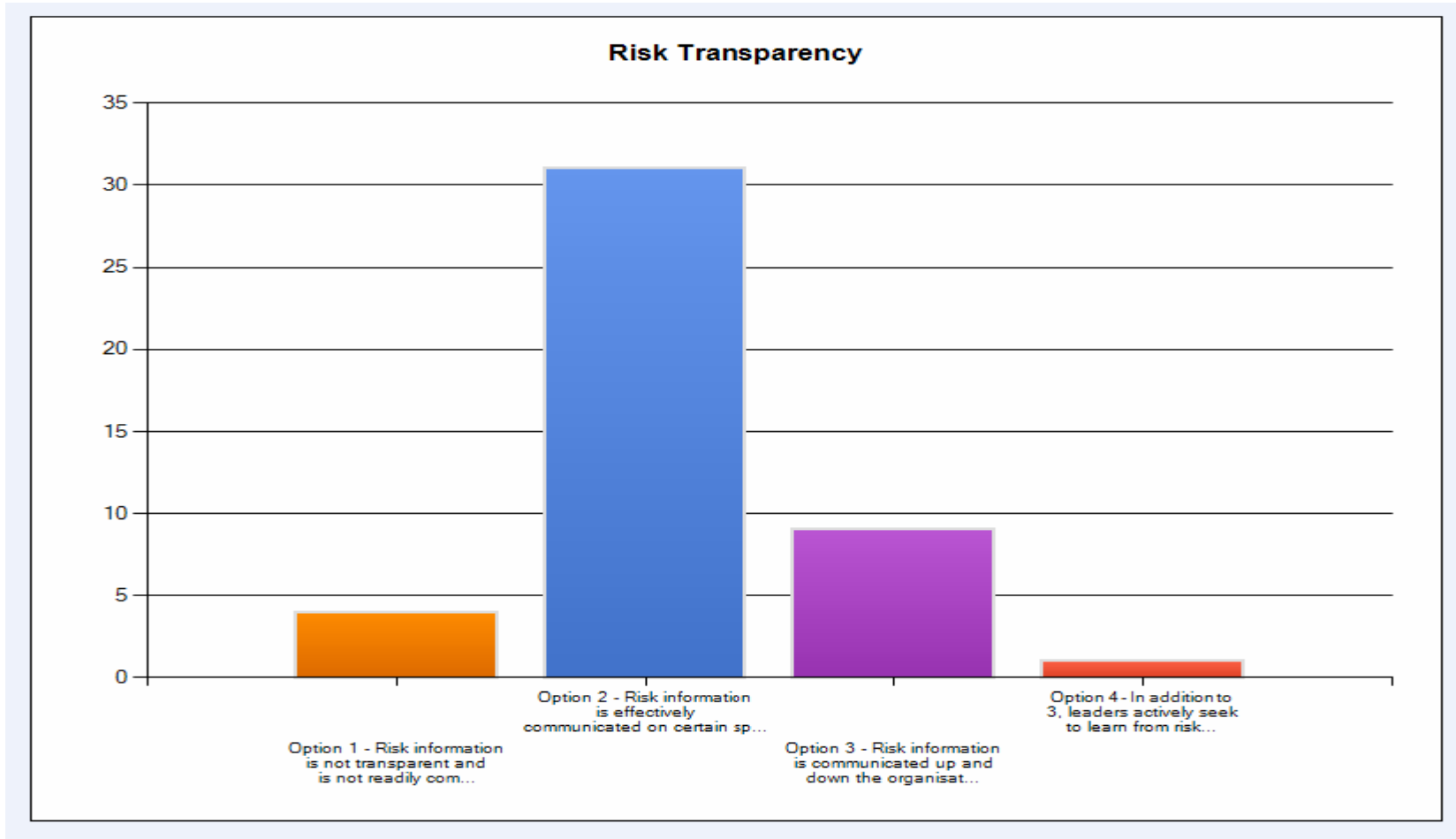
- Risk decisions
- Rewarding appropriate risk taking

See article in *Risk Management Professional* on this diagnostic tool

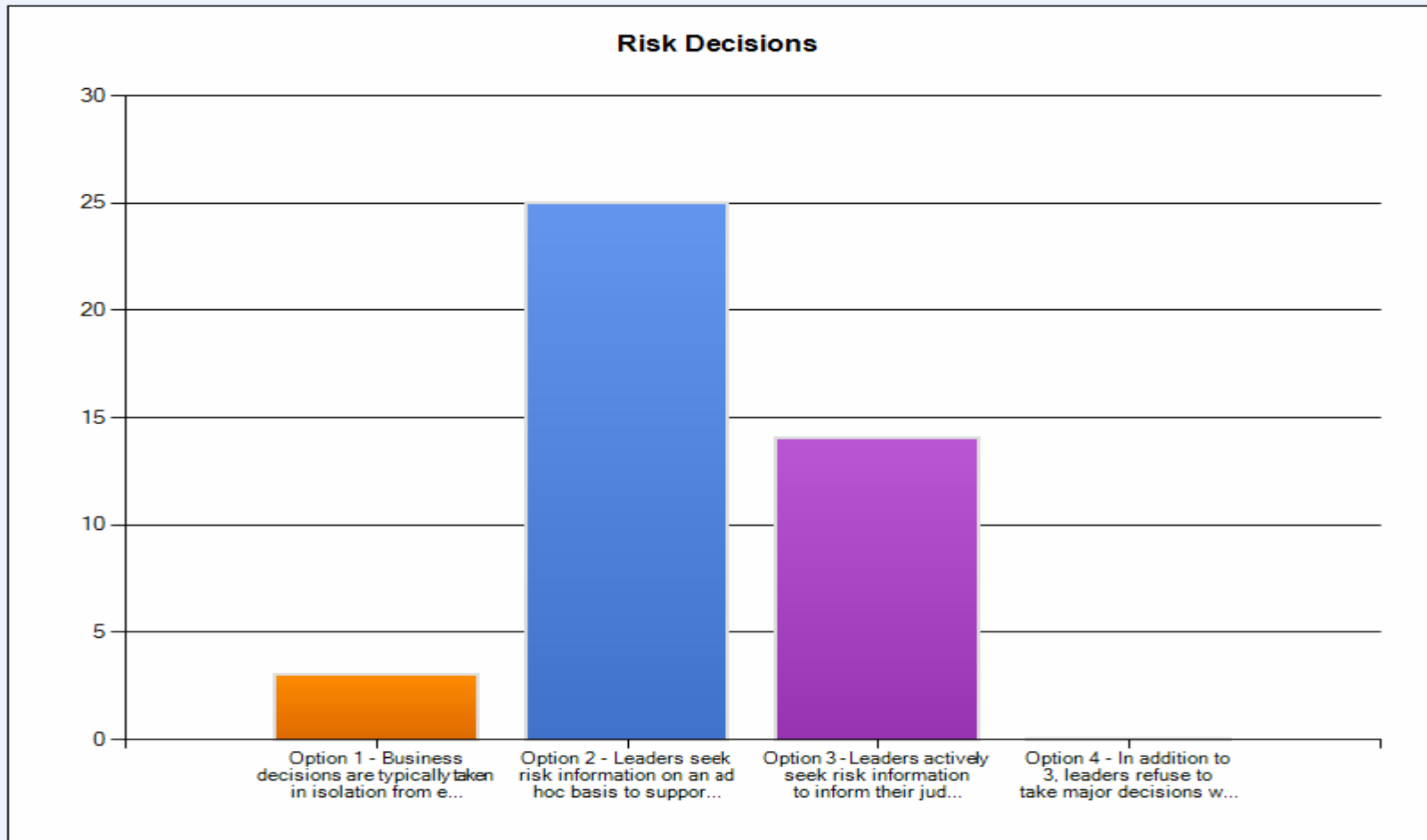
Summary of recent survey

- 48 respondents within Institute's **Solvency II special interest group**.
- Very candid responses - there is a **significant task ahead** to embed risk management in organisational cultures
- Few appear to have a **coherent strategy** to developing risk culture
- In many cases risk management is **being developed in isolation** from the business still
- **Risk Leadership** – how to get management and Board's to **SHOW** sustained interest and commitment?
- **Risk Transparency** – how to provide information useful and timely for management decisions and move beyond compliance?
- **Risk Competence** – Weakest area and key to 'winning hearts and minds' – where is the focus on training and development?
- **Risk Decisions** – how to provide the right information to support management decisions and demonstrate its use?
- **Rewarding appropriate** risk taking – how to connect risk management to the performance management & appraisal system?

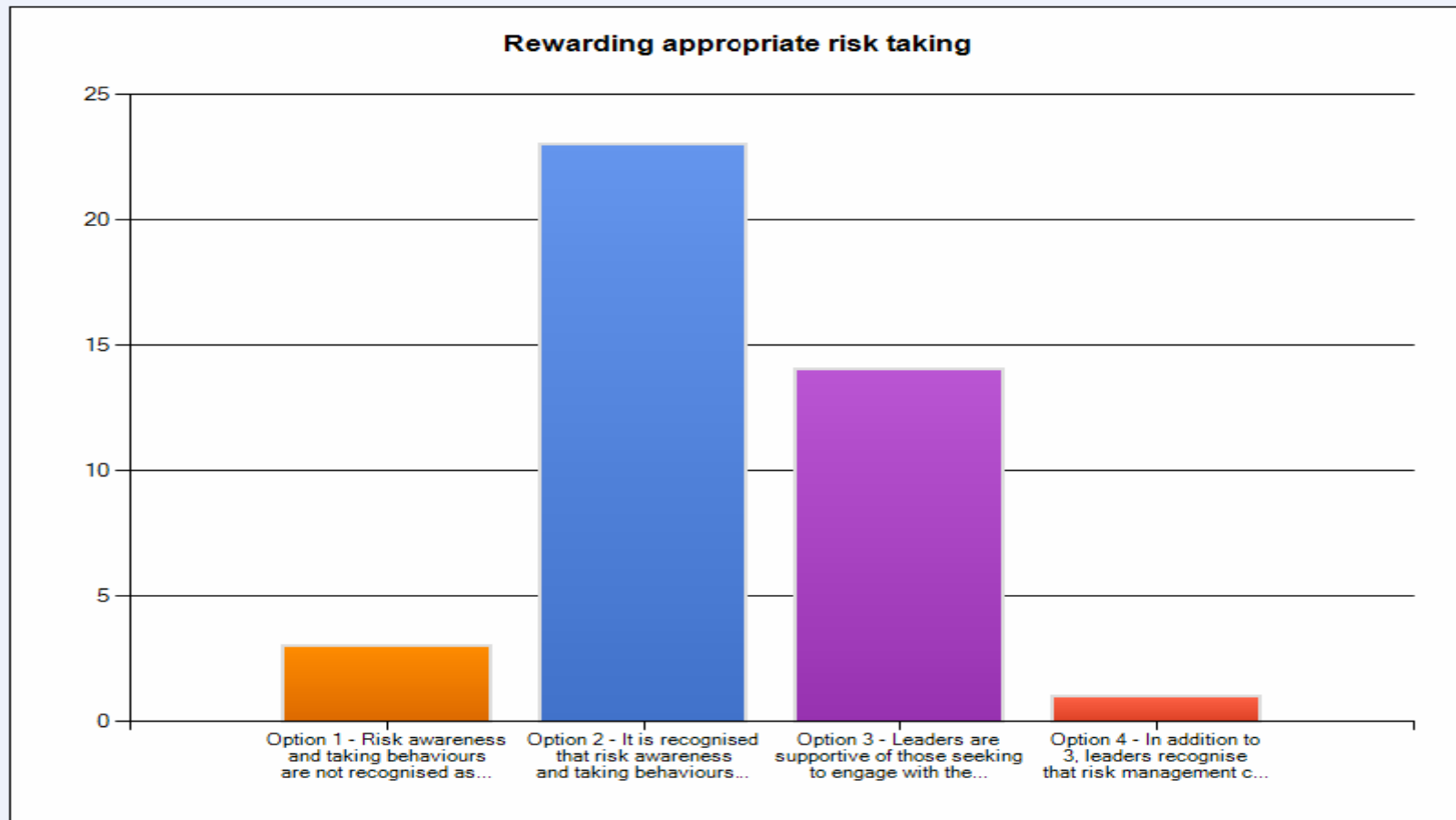
Risk transparency



Risk decisions



Rewarding appropriate risk taking



Download survey from <http://www.theirm.org/events/SolvencyII.htm>

Diagnosing organisational culture

Common Governance Spirit

Widely held system of shared meanings

Rules are adhered to

**Control
Governance**

**Strategic
Governance**

**Engaged
Culture**

**Complier
Culture**

Systems of Control

Strong pressure to conform

to a shared system of meanings

- Rules are set to guide behaviour -

Independence

Increasingly independent of
other people's pressure to conform

- Staff are left to be guided
by their own values -

**Chaotic
Culture**

**Sleep-walking
Culture**

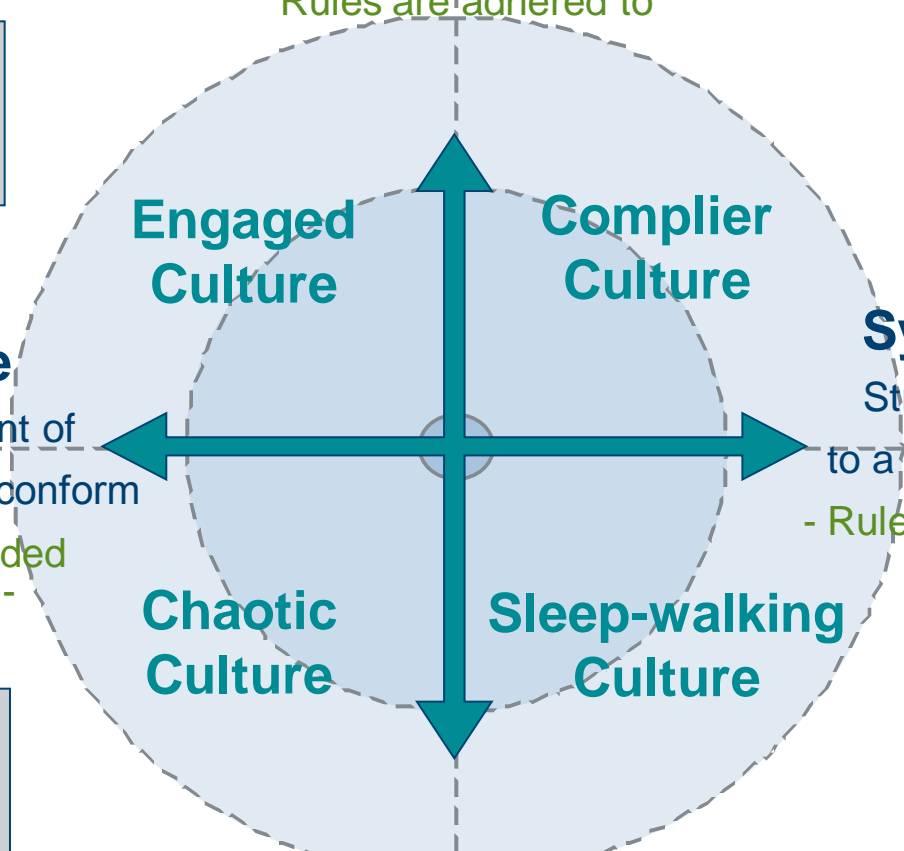
**Minimalist
Governance**

**Tactical
Governance**

Weak Governance Spirit

Private system of meanings

Rules are not implemented



Style of ERM implementation

Common Governance Spirit

Widely held system of shared meanings

Rules are adhered to

'Sell' Risk Management

'Watch' people comply

Systems of Control

Strong pressure to conform to a shared system of meanings

- Rules are set to guide behaviour -

'Pray' it works

'Tell' people how to act

Weak Governance Spirit

Private system of meanings

Rules are not implemented

Independence

Increasingly independent of other people's pressure to conform

- Staff are left to be guided by their own values -



'Moving' the culture

Common Governance Spirit

Widely held system of shared meanings

Rules are adhered to

**Regulated organisation
where compliance can
stifle creativity**

Systems of Control

Strong pressure to conform
to a shared system of meanings

- Rules are set to guide behaviour -

Independence

Increasingly independent of
other people's pressure to conform

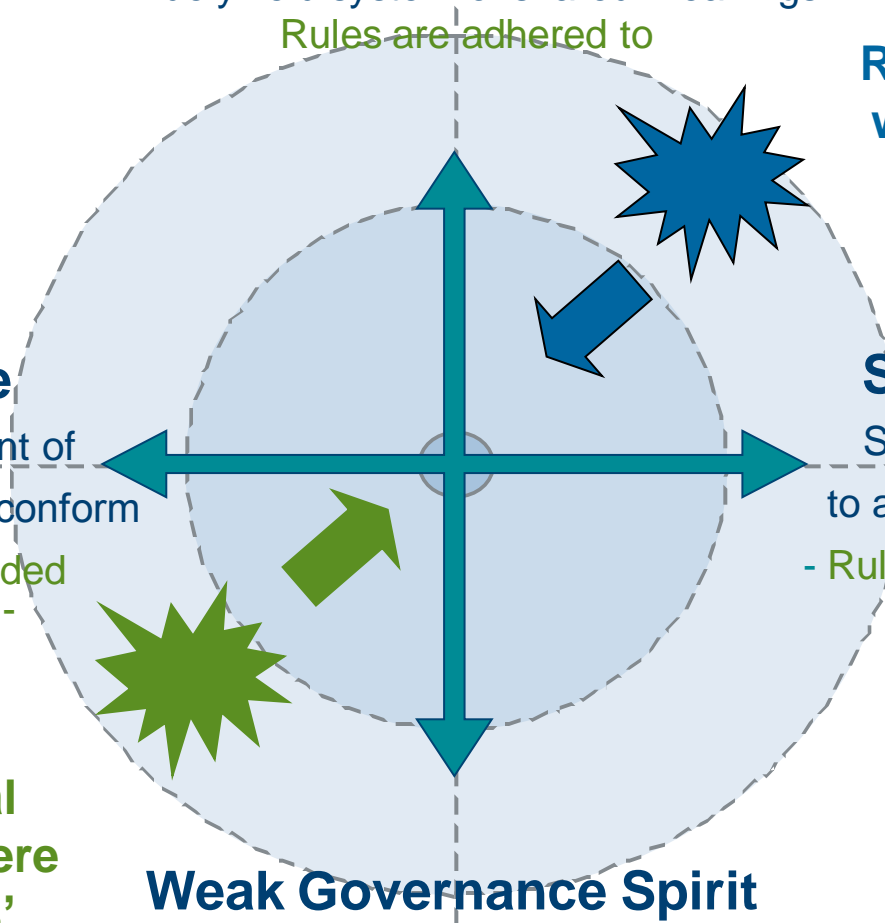
- Staff are left to be guided
by their own values -

**Entrepreneurial
organisation where
'anything goes'**

Weak Governance Spirit

Private system of meanings

Rules are not implemented



How can this be done?

A risk culture needs to be **proactively fostered** and shepherded towards desired outcomes. A constructive risk culture would have the following characteristics:

- **Leadership behaviours support & encourage appropriate risk taking**
- Executive sponsorship is clear
- Risk awareness is encouraged
- People learn from poorly managed risks without 'shooting' the bringer of bad news
- Appetite and boundaries of risk taking are discussed and agreed
- Roles and accountabilities for managing risks are defined
- Risk is visible in key decision making
- Skilled risk taking is rewarded and valued



Leadership behaviours to foster risk culture

- Signalling that managing risk is part of **everyone's** responsibilities
- Signalling that managing risk is part of **'business as usual'** and is a valued skill
- Clearly communicating **boundaries of acceptable** risk
- **Encouraging, empowering and supporting** team members in managing risks
- Encouraging challenge and **learning** from risk management judgements
- **Encouraging discussion** and analysis of unexpected results
- Securing **training and support** to ensure that those tasked with managing risks are capable of doing so

Culture is key to 'embedding' and 'use test'

- Risk awareness
- Common language
- Risk Appetite
- Training & Development
- Communication and Engagement
- **Risk Ownership and Accountability**
- **Performance & Recognition**



The 7 embedding 'tests'

Test	Is Risk Management....	Meaning
1	Sponsored	Leadership clearly sponsor and challenge activity.
2	Owned	Ownership accepted and acted upon at all levels.
3	Decisive	Influences key decisions.
4	Communicated	Outcomes are visible and actively discussed.
5	Integrated	Part of day-to-day core processes and procedures
6	Valued	Pride and commitment drives continuous improvement
7	Sustained	Robust, reproducible and not dependent on single individuals

How to use the embedding tests?

- The 7-tests are extremely simple but very challenging to deliver against
- ‘Baseline’ score each division/function against key element of a framework or ‘culture tests’
- Identify themes across the organisation and develop improvement plans
- Track progress with periodic re-assessment

Level of embedding and criteria	
5	Approaches to managing risk are fully embedded in day-to-day business processes and strategies.
4	Approaches are adopted and improving but not fully embedded.
3	Implementation has been completed in key areas.
2	Implementation is planned but not delivered.
1	There is a level of awareness or understanding but no action has been taken.

See forthcoming article on
“Embedding risk management – Holy Grail or measurable outcome?”

Maintaining momentum

- Ask management to self-assess and provide 'evidence'
- Benchmark internally and create an element of competition
- Measure the contribution of specific Risk Owners or Coordinators towards driving embedding.
- Show this is a change that is destined to 'stick'

Activity	Summary of scope	Entity 1	Entity 2	Entity 3	Entity 4	Entity 5	Entity 5	Entity 6	Entity 7	Entity 8	Target end 2010	Target end 2011	Average
Risk Strategy	Risk Management Framework understood & communicated. Policy direction championed actively.	3	3	2	2	3	2	3	2	3	3	4	2.5
Risk Standards	Risk Standards are adopted, gap analysis completed and improvement plan agreed.	2	2	2	2	2	2	2	2	2	3	4	2.0
Risk Appetite & Tolerances	Risk appetites and tolerances are agreed and risks are monitored against these.	3	3	2	2	3	3	3	3	3	3	4	2.7
Accountabilities and Ownership	Accountabilities within the risk process are understood, agreed and acted upon.	3	3	3	2	4	2	3	3	3	3	4	2.9
Risk identification & assessment	Risks are proactively identified, discussed and evaluated using the risk system to capture conclusions.	3	2	2	2	4	3	2	2	2	3	4	2.5
Risk Response	Improvement plans are agreed and acted upon where necessary to address deficiencies or risk events.	3	2	2	2	2	1	3	2	2	3	4	2.0
Risk Reporting	Risks, including emerging risks and risk events are proactively reported by coordinators with limited input from the risk function.	2	2	1	1	3	2	3	3	2	3	4	2.1
Risk Review & Governance	Governance arrangements are clearly defined and acted upon. Management and Boards review & challenge risk data.	3	3	1	2	3	3	3	3	3	3	4	2.7
	Average	2.8	2.5	1.9	1.9	3.0	2.3	2.8	2.5	2.5	3.0	4.0	2.4

Conclusions

- Your organisation already has a risk culture – **but do you understand it?**
- Changing a risk culture does not happen by accident, **you need a plan**
- Make the link to organisational values, it will put risk culture into **context**
- Any changes you wish to make need embedding – **how do you know how you are doing?**
- There are tools available to diagnose culture and develop improvement plans – **make use of them**
- Remember, Board and management sustained commitment, **is critical to success**
- And - Its all about *Change Management*

Questions?

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