



Leading the risk profession

Risk Culture

What is it? How do I get one?

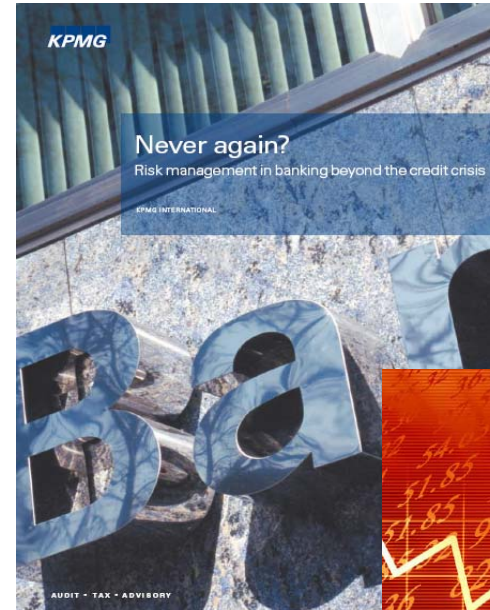
Alex Hindson

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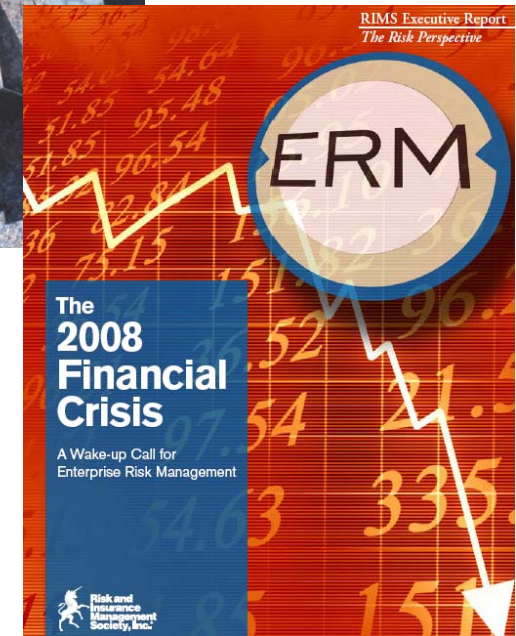
Risk Culture & The Credit Crunch



“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.”



Rating Agency response



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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?



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“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”

Anyone can write a Code of Ethics...

***Enron Code of Ethics
July 2000***

Getting it wrong can be painful...



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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?



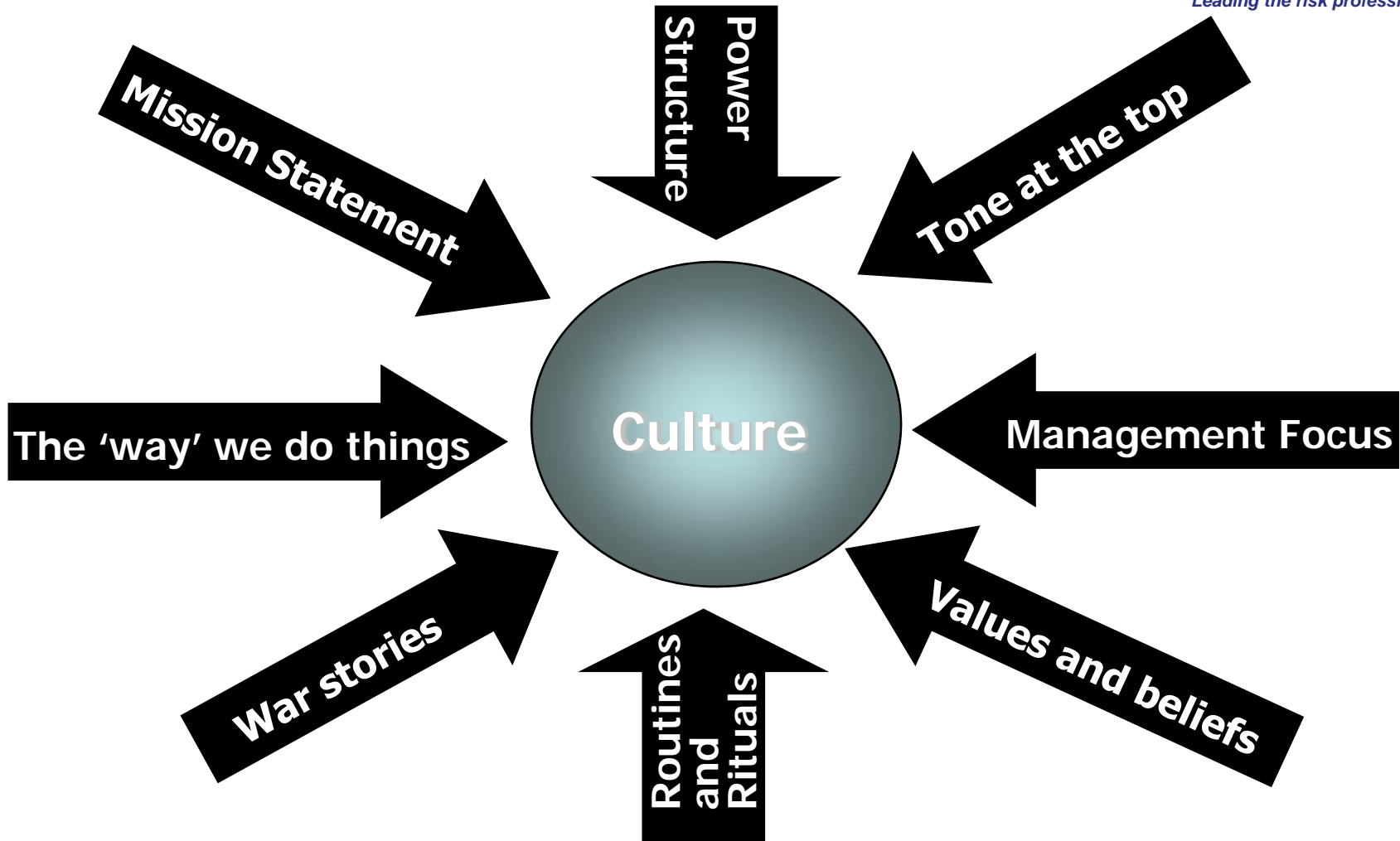
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- A set of rules?
- A common language?
- A business process?
- Effective tools?
- A set of shared values?
- A common perspective ?
- Consistent behaviours?

A culture is complex...



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How is culture manifested?



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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?



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“**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...



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Common Governance Spirit

Widely held system of shared meanings
Rules are adhered to

Independence

Increasingly independent of
other people's pressure to conform

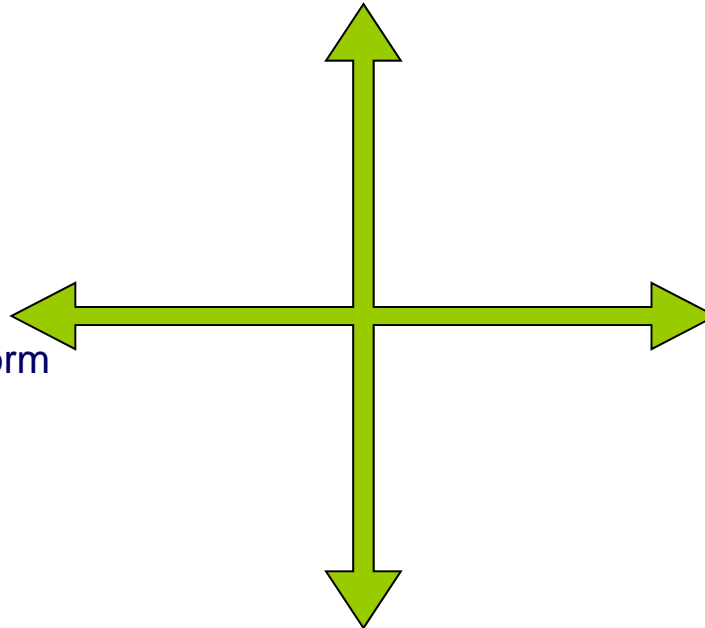
- Staff are left to be guided by their own values -

Systems of Control

Strong pressure to conform
to a shared system of meanings
- Rules are set to guide behaviour

Weak Governance Spirit

Private system of meanings
Rules are not implemented



Diagnosing organisational culture



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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

Independence

Increasingly independent of
other people's pressure to conform

to a shared system of meanings

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

- Rules are set to guide behaviour

**Chaotic
Culture**

**Sleep-walking
Culture**

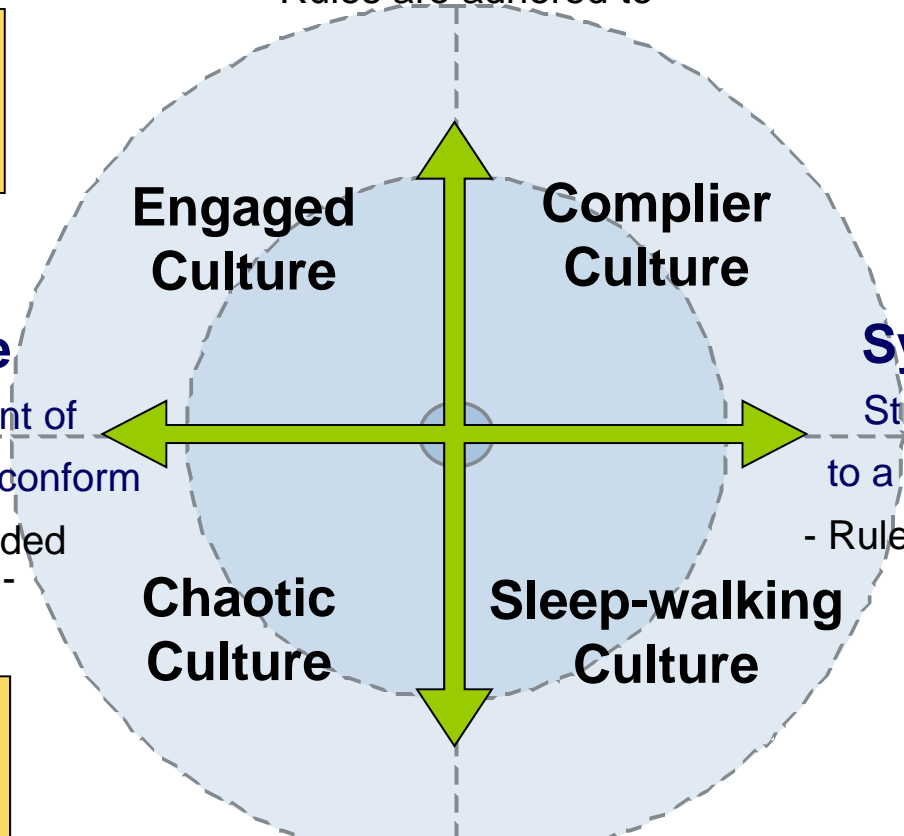
**Minimalist
Governance**

**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

Independence

Increasingly independent of other people's pressure to conform

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

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



'Moving' the culture



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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

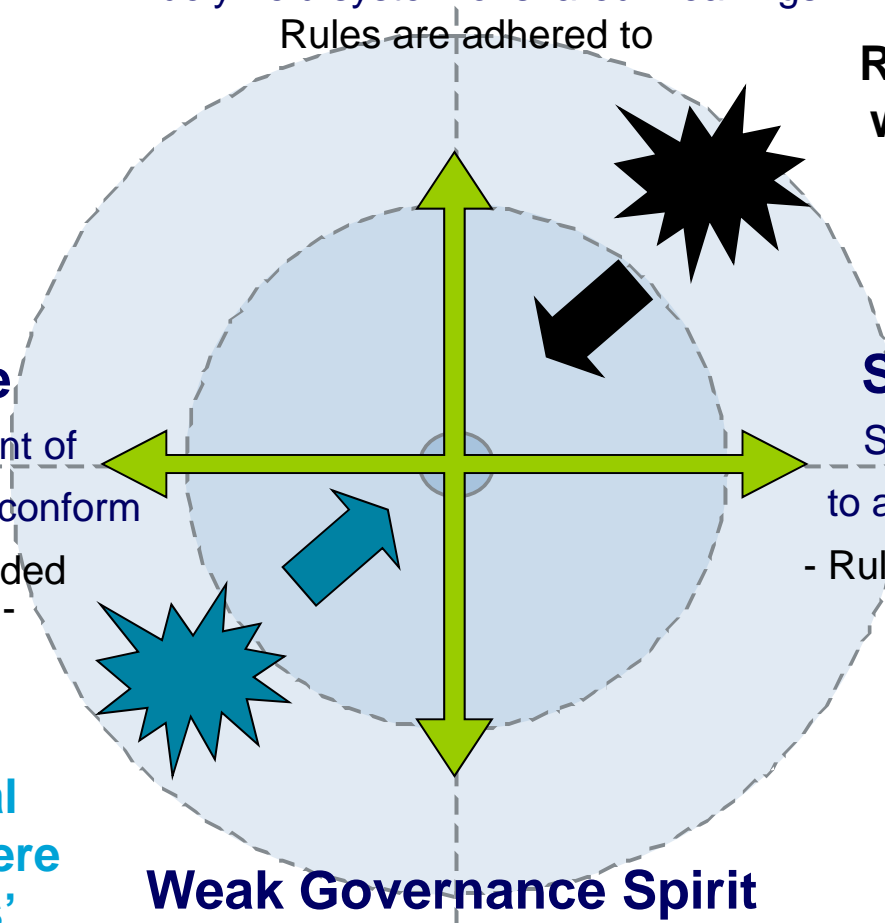
- Staff are left to be guided
by their own values -

**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



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- 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'



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





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Questions?

Alex Hindson

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