

IRM Special Interest Group

London, November 2011



Risk Management Effectiveness

Drivers, Frameworks & Improvements in 2012

EY Paper



CROs and CEOs want progress

The robust logic behind effective risk management means that it is desirable for all businesses. Ensuring that risk management frameworks are effective seems to be the next big risk management challenge for businesses because:

- CEOs and CROs want their risk capability to be effective.
- There are regulatory drivers requiring it. For example, Article 44 (1) of the Solvency II Directive contains statements such as, “The risk management systems shall be effective and well integrated into the organizational structure and in the decision making process... Proper consideration of the persons who effectively run the undertaking or have other key functions.”

Understanding the degree of effectiveness is important, but often hampered by the lack of a comprehensive structure for the assessment. As a result, assessments can sometimes be too general or overly subjective.

Some initial feedback

Thanks for this - very interesting. Happy for you to contact me in due course.

- **Regional CRO of a bancassurer**

Thanks for forwarding interesting report. I agree with most of findings.

- **Global CRO of Europe based Insurer**

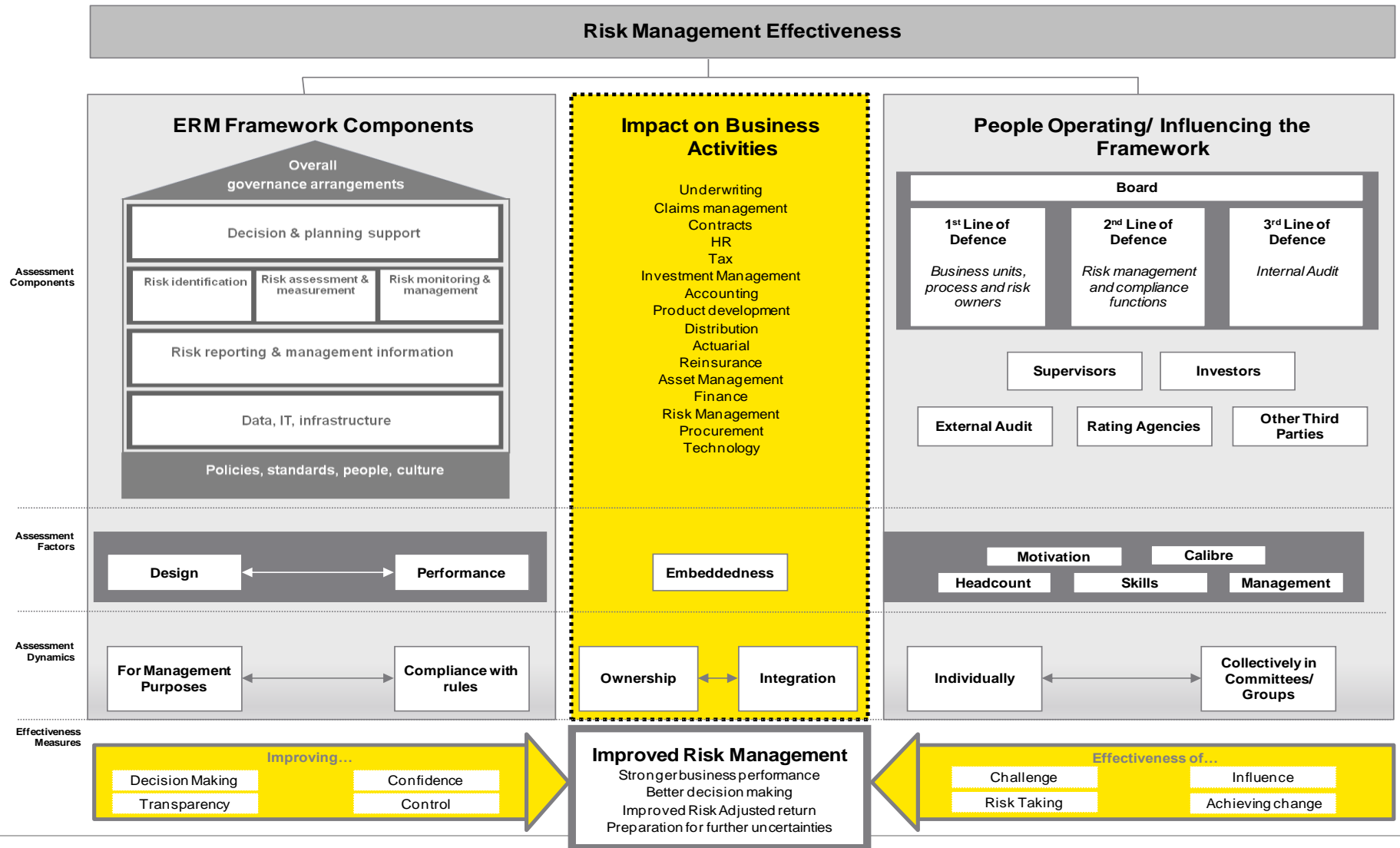
I thought it was a very good summary. Happy to talk at some stage.

- **UK CRO of a global insurer**

A very interesting and challenging area for Risk and the business. I certainly recognise the imperative, and I really liked the CEO/CRO interface component. Happy to talk through the paper.

- **Head of Op Risk, bancassurer**

Framework for assessing effectiveness



Some extracts... commercial rationale

Given the fundamental business benefit to be derived from more effective risk management frameworks, effectiveness improvement should be desirable to CEOs and CROs even in the absence of regulatory pressure.

This type of effectiveness framework provides a useful way for these forward-thinking businesses to harness greater value from their risk management investment.

Some extracts...CEO desire

Common questions from CEOs include:

“Now I have suitably skilled people in my risk function, how can we make sure they are focused on the right areas of business uncertainty?”

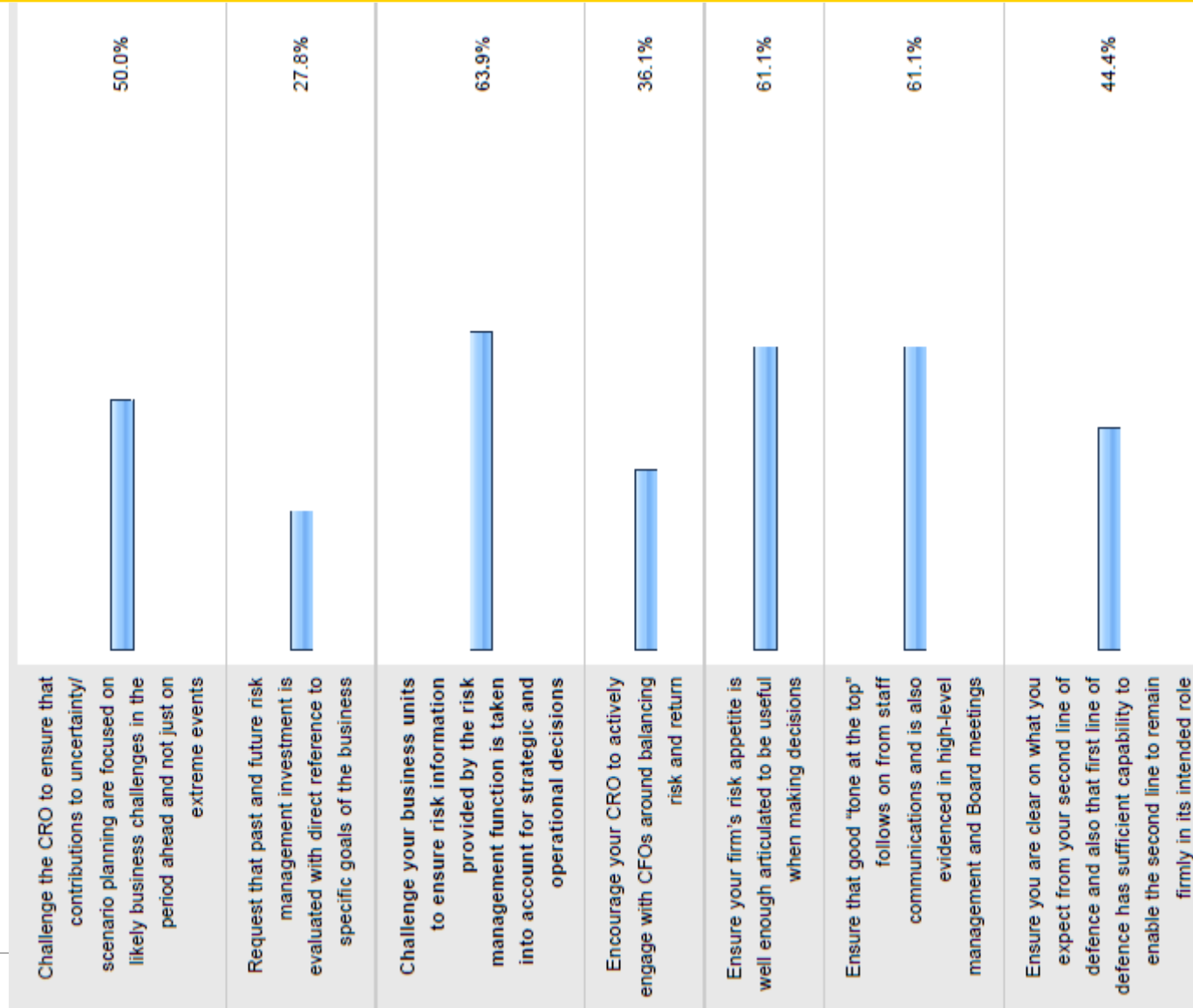
“Now that we have a good risk management framework by design across all three lines of defense, how can I make sure it is actually effective in practice, globally?”

“I’ve spent a lot of money on risk management, so how can I make sure I get maximum benefit from it?”

Ideas for improving CEO/CRO Interface

CEO actions	CRO actions
<p>Challenge the CRO to ensure that contributions to uncertainty/scenario planning are focused on likely business challenges in the period ahead and not just on extreme events.</p>	<p>Ensure that discussions regarding contingency planning (for disaster management purposes) and scenarios for capital modeling are distinct from dialogue relating to month-to-month business uncertainties and, more likely, situations resulting from client, competitor or distribution channel actions.</p>
<p>Request that past and future risk management investment is evaluated with direct reference to specific goals of the business.</p>	<p>Relate all discussions regarding change in risk levels to specific goals of the business.</p>
<p>Challenge your business units to ensure risk information provided by the risk management function is taken into account for strategic and operational decisions.</p>	<p>Use the first line of defense to ensure that risk management instructions to the business units do not come from the second line.</p>
<p>Encourage your CRO to actively engage with CFOs around balancing risk and return.</p>	<p>Avoid pursuing de-risking without sufficient consideration of potential upside or economics of increased control.</p>
<p>Ensure your firm's risk appetite is properly articulated when making decisions.</p>	<p>Highlight any deficiencies in expressions of, and/or use of, risk appetite and risk tolerances.</p>
<p>Ensure that good "tone at the top" follows on from staff communications and is also evidenced in high-level management and board meetings.</p>	<p>Discuss ways in which you might be able to support the CEO further in ensuring the tone from the top stays consistent behind closed doors at the senior level.</p>
<p>Ensure that you are clear on what you expect from your second line of defense and also that first line of defense has sufficient capability to enable the second line to remain firmly in its intended role.</p>	<p>Challenge the CEO if you believe the first line capability is insufficient, making it clear why that interferes with your ability to deliver on your second line responsibilities.</p>

SIG Survey: CEO behaviours... benefit org...



Some extracts... absence from SII plans?

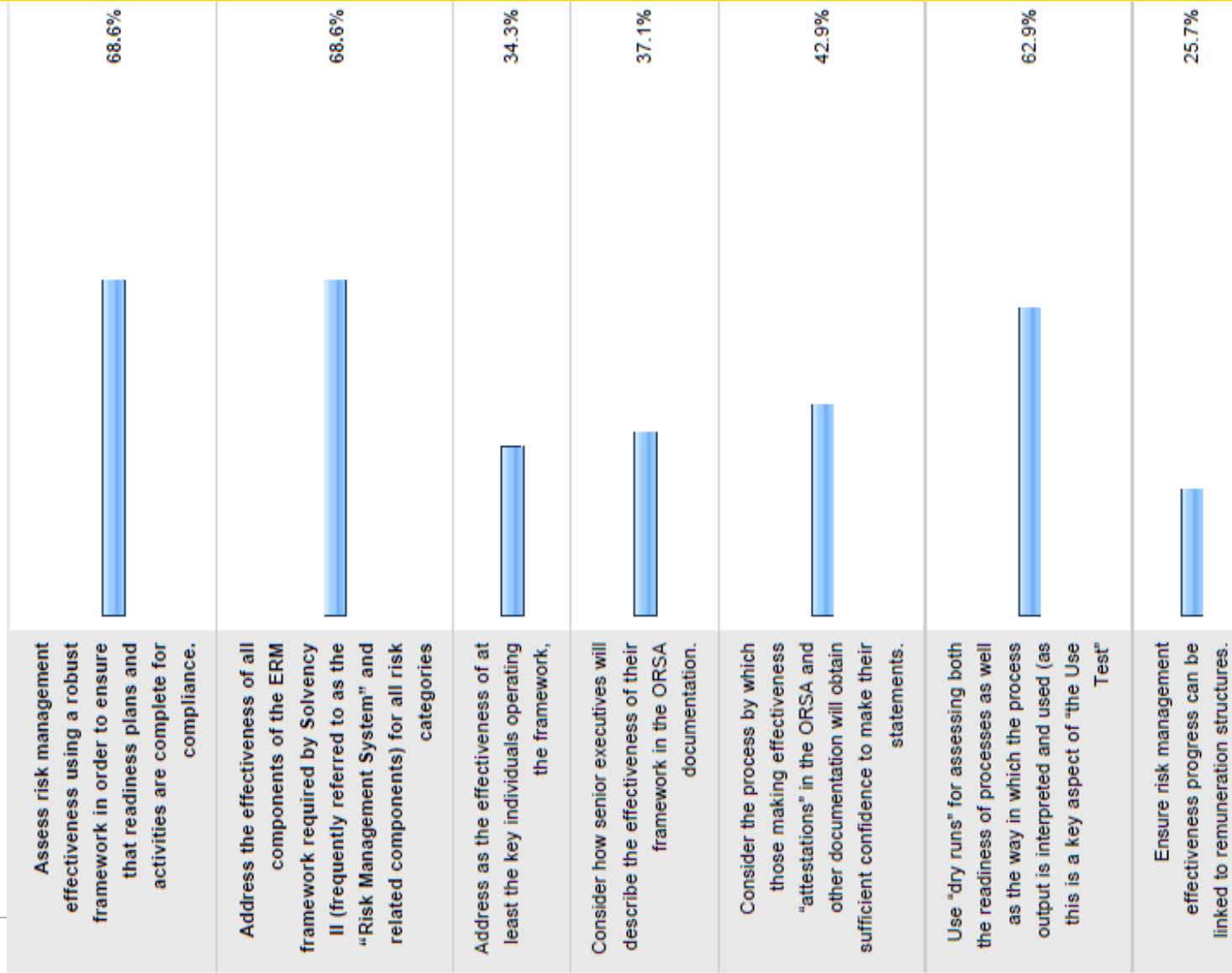
It is interesting to note that while Solvency II requires risk management frameworks to be effective, many Solvency II readiness programs are only really dealing with the design and implementation of components and, as a result, many insurers are not yet planning to assess or ensure effectiveness as part of their readiness programs.

There would seem to be a gap, but the extent of challenge from supervisors is likely to be a key determinant in the degree of focus that firms give to such programs.

Solvency II readiness recommendations

Action	Comment
Assess risk management effectiveness using a robust framework in order to ensure that readiness plans and activities are complete.	Very few Solvency II readiness programs are using a structured framework for understanding effectiveness.
Address the effectiveness of all components of the ERM framework required by Solvency II (frequently referred to as the “Risk Management System” and related components) for all risk categories.	Many programs are focused only on design effectiveness of the RMS components, rather than including their operating effectiveness.
At a minimum, address the effectiveness of the key individuals operating the framework.	Vacant roles/resource needs tend to be addressed in SII programs, but the capability of those already in place is not yet frequently addressed.
Consider how senior executives will describe the effectiveness of their framework in the own risk and solvency assessment (ORSA) documentation.	High level of awareness on the need to describe effectiveness but more limited consideration so far of the potential impact of describing anything other than “fully effective”
Consider the process by which those making effectiveness “attestations” in the ORSA and other documentation will obtain sufficient information to make their statements.	Once ownership issues relating to these “attestations” are resolved, it is likely that there will be more activity relating to the methods and routes by which assurance will be provided on an ongoing basis.
Use dry runs for assessing both the readiness of processes, as well as the way in which the process output is interpreted and used (as this is a key aspect of the use test	Although dry runs are being built into readiness plans, the focus tends to be towards the production of the output rather than on the use of the output.
Ensure risk management effectiveness progress can be linked to remuneration structures.	Many programs are ensuring that remuneration structures “don’t encourage inappropriate risk taking” but many have not yet worked out how risk management effectiveness improvement would be linked to remuneration.

SIG Survey: Does SII project contain...



Some extracts... measurement approaches

We have seen two types of approaches being used internationally to measure risk management effectiveness.

One approach tends to be subjective, principles-based and flexible, and the other tends to be more process-driven and rules-based.

Whatever a firm's preferred approach, there is the need to understand the level of effectiveness in proper context.

We think it is important that the coverage is comprehensive and that the conclusions are constructed properly.

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