

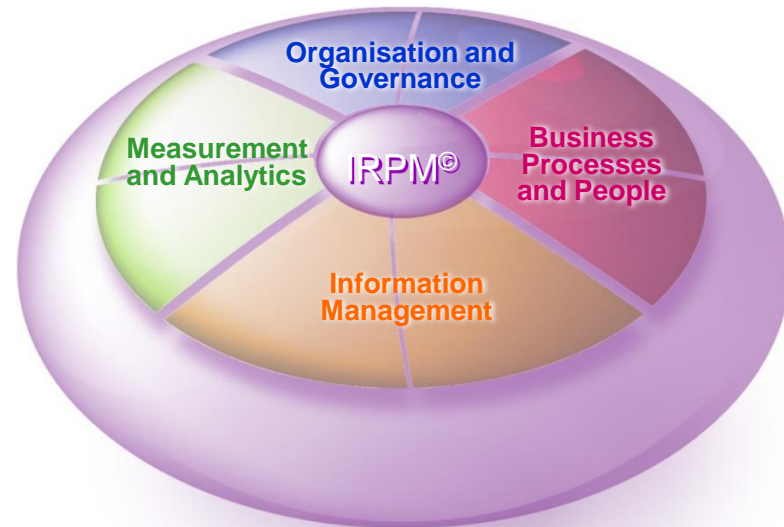
The Developing Role of the Risk Function under Solvency II

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- **Three Changes in Risk Management:**
 - **Governance**
 - **Cultural Change**
 - **Professionalism**
- **The role of the CRO**
- **Conclusion**



THREE CHANGES IN RISK MANAGEMENT

- **The world of Risk Management is changing, partly because of Solvency II, but also due to other pressures. Risk as a discipline is coming of age.**
- **Continued change by the Risk function is needed to ensure that risk managers have the knowledge and support to perform their jobs properly within the regulatory and business environment.**
- **I want to focus on three themes within the changing Risk Management environment:**

Improved governance



Risk culture

Professionalisation

THREE CHANGES IN RISK MANAGEMENT | Governance

- **Improved governance is essential to avoid future corporate failures.**
- **There must be a clear separation of powers between the executive and those accountable for overseeing their actions. In the past, executives had more power in relation to non-execs and other independent challenge (Risk and Internal Audit) than was healthy.**
- **But, companies need to focus on effective governance.**
- **Governance can become a coating: focus on proportionate, effective governance processes.**
- **In some companies governance can get in the way of first line decision-makers making truly risk-based decisions. For example:**
 - **Who is the decision-maker – committee or first line?**
 - **Does lengthy governance prevent good risk-based real time decisions?**



THREE CHANGES IN RISK MANAGEMENT | Risk Culture

- **For these reasons, culture is more important to risk management than process and structure.**
- *“Even after all the supposed lessons learned exercises, we are still seeing some decisions by management in major firms that we would judge not to be prudent”*
- *“The end goal should be that firms understand their own culture and the potential risks posed by the wrong culture.”*
 - *Hector Sants, June 2010*
- **Consider the “down the pub” or the “mother in law” tests.**
- **A clear distinction between three lines of defence is important and includes a change in culture of the first line. For example, the head of pricing must also focus on risk matters and not just solely on selling. (“We are all risk managers.”)**
- **How can we prevent this distinction which is clear in current times from unwinding as commercial pressures start to outweigh risk considerations?**



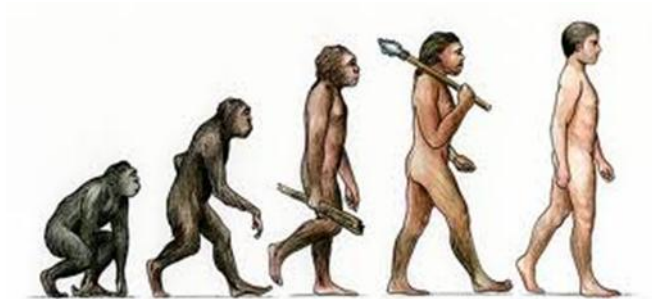
- partly by the professionalisation of Risk.
- A profession is defined by an adherence to values above loyalty to any one company.
- “Risk Managers” are developing our own recognised profession. This is enhancing capability, competence and professionalism.
- There is now excellent training at degree level, postgraduate level and professional qualifications in Risk Management.
- Technical capability is important, but so are the softer skills: challenge, independence, values, diligence, ability to be assertive, effective relationships.

The CRO will establish a clear risk strategy to ensure risks are properly identified, measured, managed, monitored and reported, eg:

- **Risk assessment focused on foresight.**
- **Distinction between “risks” and “issues”**
- **Review and strengthen the end-to-end risk process.**
- **Effective reporting.**
- **How do you know risks are being effectively mitigated?**
- **Effect a cultural change within the organisation.**
- **Work in collaboration with the business and Risk Committee.**

- **The risk function as embodied by the CRO has a unique and privileged position in the organisation.**
- **For the CRO to be effective, (s)he should be independent of line business management and have sufficient internal voice to have a meaningful impact on decisions. Typically (s)he will be a member of the Board or Executive Committee.**
- **FSA is setting out in SYSC 21 its requirements of a CRO:**
 - **independent**
 - **sufficient authority, stature and resources for effective execution of responsibilities**
 - **unfettered access**
 - **provide oversight and challenge**
 - **report on the firm's risk exposures relative to its risk appetite and tolerance**
 - **etc....**

- The CRO will work with and through other risk managers within the organisation.
- Effective relationships with every part of the organisation are important: senior management, operations, finance, legal, human resources, actuarial, etc.
- The role is a proactive one, not just a monitoring role.



CONCLUSION

- **A significant driver of the last financial crisis was the poor risk culture in certain organisations.**
- **Governance is important, but is not the whole solution (although some companies think it is (especially when subject to a governance 166)).**
- **Culture is more important.**
- **Regulatory reforms such as Solvency II and the FSA PS 10_15 (to come into force from 1st May 2011) are directly applicable to the changing and challenging role of a CRO.**
- **But it is not the CRO alone who will effect this move towards effective risk management. All the comments I have made in respect of the CRO are equally applicable to each member of the Risk function.**
- **The changing role of “risk mangers”, including the move to a Risk profession is important to prevent the current reforms unwinding.**