Primary Roles of Actors in Risk Governance

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Agenda

- Background : Roles and Accountabilities
- Rising demands of stakeholders in 2013 and 2014
- Arguments
- Corporate Misunderstanding
- Shift in Culture
- Case Study: A British Insurance Company

Background

Roles and Accountability

- The foundation of roles in risk governance arises from accountability
- We argue that roles and accountabilities are inseparable
- Post-2008 crisis, expectations of regulators, investors, credit rating agencies, customers and other stakeholders have risen (Gulko, Hyde, & Seppala, 2017).
- Board members are surrounded by accountability pressures for negligent risk-based decision making and for establishing inadequate risk management procedures

- *“Accountability pressures mean that an organisation must be able to document how resources have been used and to reconstruct organisational rules and actions that produce particular outcomes.” (Dutton & Ottensmeyer, 1987, p355)*

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Roles of the Board

Companies at Nascent Stage

Role 1: Providing Risk Oversight and Risk Appetite statement

Role 2: Understanding Top Strategic Risk

Provide platform for risk infrastructure

Role 3: Risk based decision making

“What to implement, how to implement and who will implement it in risk related matters”

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Roles of the board

Companies at Advanced Stage

Role 4: Inquire for adequate system, process, and rules for Enterprise Risk Management

Role 5: Stakeholder management (i.e. investors demanding higher disclosures, regulator, credit rating agencies)

Role 6: Strategic Issue Management

“What are the problems in understanding risk and implementing risk management , who are impacted from these problems and how these problems can resolved”

Roles of the board

Companies at Mature Stage

Role 7: Use Risk governance as a strength to exploit opportunities and gain competitive advantage

Role 8: Reduce Risks

Role 9: Improve Risk Management

Role 10: Development of Good risk Culture for sustainability

“ How to Improve risk governance”

Accountabilities

- Who set the accountability for these roles?
- The roles with the higher accountabilities received higher priority than others

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2013: A demand for Integrated Reporting from the investors

Problem

Before 2008 – Lack of disclosures

Post 2008 – Over Disclosures (CSR Reporting, Sustainability Reporting)

Investor demanded ‘One Report’ consisting of all material information in succinct manner

Formation of International Integrated Reporting Council (IIRC)

Q: What is material information to investor?

- The IIRC’s mission is to establish integrated reporting and thinking within mainstream business practice as the norm in the public and private sectors.
- Lesson: “Integrated Reporting is not possible without integrated thinking”

2014: A Bleeding year of Regulatory Penalty for financial institutions

- According to a Bloomberg study banks globally have paid $ 321 billion fines due to non-compliance to regulatory guidelines, money laundering, market manipulation and terrorist financing.
- Year 2014, was a big year of penalty which bleeded the banking industry worldwide. Insurance industry was not lagging behind.
- Armour, Mayer and Polo (2017) carried out a research with the support of Oxford University and found that financial firms worldwide are not only facing penalties for non-compliance of regulation but also a suffer from series of reputation losses.
- Reputational losses are nearly nine times the size of fines and are associated with misconduct harming customers or investors but not third parties.

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Companies were forced to think what went wrong?

Why regulators are unhappy?

Why investors are not satisfied with current disclosures?

Arguments : What Companies should do?

- <u>Argument 1: </u>The structured risk governance is normative and compliance oriented
- <u>Argument 2: </u>The regulator demands enhanced focus on the development of risk culture
- <u>Argument 3: </u>Equal weightage should be given to the development of risk culture and formalized risk governance balancing regulator and market forces
- <u>Argument 4: </u>Risk Governance should be proactive in nature due to its high value for business and need continuous improvement

"Tone from the top and its influence on risk management."

Corporate Misunderstanding

Why numbers do not work everywhere

- "**There is expectation that Risk management can become almost like accountancy that's all about numbers.** In my opinion, they entirely messes the point. It is easier in actuarial world to give number to Credit risk which I think can be useful to some extent. But we do work on Operation capital and people who work on numbers there are completely spurious accuracy. All heads are proxy. **I think people need to head around the fact that Risk management is more qualitative than quantitative**"

–Group Risk Director of a large Insurance Company in the UK

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Corporate Misunderstanding

“I create the rules for the people and policies. I propose a road you to go. I know sometimes that you are off the road. When you go off the road what drives your behaviour? If it is for making great things for customer and stock mix, that’s what risk culture is about or this is about to make money commercially – only incentive making – that’s where you got failed. So when the people go off the road, have they got moral campus to follow that is Risk Culture? Its not about Risk framework and Risk process – these are the only construct to stay in.”

- Group Risk Director of a large Insurance Company in the UK

A shift in culture from quantitative to qualitative aspects

Issues	Reasons
1. Risk Governance solely implemented for regulatory purposes -No focus on improvement in the quality	Negligible rewards
2. A deterioration in the accuracy, robustness, and timeliness of Risk Governance which is not picked up by company's internal process	Weak Internal Audit
3. Lack of continuous improvement	No progress
4. Regulatory flexibility	Negligible improvement in the quality of risk governance in few years

Case Study: One of the oldest and leading Insurance Company in the UK

Introduction of new role of ‘Risk Director’

Roles of Group CRO	Role of Group Risk Director
Responsible for Company Risk, Conduct and Compliance.	Responsible for Financial and Insurance risk management across Group
Stakeholder Management in risk related matters i.e. Over £500 Billion AUM and 6 million customers.	Risk Management
Supervision of global business in UK , Europe, North America, Hong Kong, Singapore, Australia and Japan with local JVs in China and India serving an additional 16 million emerging markets customers	Role involves setting risk appetite, stress testing, ORSA process, Economic Capital Principles and Group Product Supervision.
External Communication	Internal Communication except to regulator
Reporting to board	Direct report to Group CRO, Chair of Group Credit Risk Committee, Chair of Actuarial Management Committee and lead relationship manager with group's regulator.

Issues

- How to develop a good Risk Culture in execution of roles of risk governance?
- Who is responsible for risk management and who is actually managing the risks? Is there any discrepancy?
- What is the scope of risk management? How we will ensure that our risk management cover enough depth and breadth?

Issue 1: Risk Culture

After Solvency II, Insurance Companies have to follow better risk/capital profile to bring capital efficiency but how?

- Better embedded use of risk management in decision making
- Better informed risk appetite and risk tolerances
- Use Tests
- Improved Model Governance

What was missing?

Problem: People take it as a end of annual review exercise

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Reviews

- The technology risk reviews were introduced
- Company is undergoing technology transformation
- Company decided to go ahead with wholesale transition to a cloud solution offered by one vendor
- Risk Management team initiated their reviews

Findings:

- Vendor was unable to show the adequate level of data security
- Failed to show clear details of development work as it claimed

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Living Risk Management

" LIVE Own Risk and Solvency Assessment (ORSA)"

- ORSA APP for all members of board and Executive Committees via their iPads
- It also provided the latest results and information

Result:

This helps to get away from any notion that the ORSA is a once-a-year activity

Issue 2: Who is responsible and who is managing the risk?

- A communication was required to provide clarity on risk responsibilities.
- For example who sign off for what ?

Alternatives:

- Unlimited responsibilities vs no responsibility
- Setting roles but no accountability
- Setting roles and accountability linking it with performance appraisal
- Setting roles and accountability linking it with risk culture

Linking Issue 1 ‘ Setting right risk culture’ with Issue 2 ‘Setting roles and responsibilities’

Risk Opinion Index and MARs

- Risk Opinion Index

A succinct description of responsibility supporting rationale and key judgements involved collected from the survey

- Management Awareness of Risks (MARs)

It consists of information for the processes to handle operational risks and conduct risks.

This supported visibility and accountability for each unit

It also help the first line executives to better score the risk exposures

Historical view with the latest information (one page- one risk)

- Risk Graduate Scheme for Young Professionals

Issue 3: Rising tensions over scope of risk

- Senior Executives and board wish to discuss only the most vital and material points in risk related matters.
- Management face challenges in showing ‘visibility of the breadth’ of risk environment and coverage of material points at the same time

Views on Risk Pack

- The aim is to enable the right conversation
- Headline page focuses discussion
- Layered dashboard structure supports this with tailored views on specific topics or areas of risk.
- It is similar to News App (i.e. BBC news, ET news) while earlier the format like Newspaper, searching relevant information was difficult

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Thanks