Influencing Culture to Deliver Better Risk Outcomes

Neal Writer – EY and Kevin Borrett - Unum

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Institute and Faculty of Actuaries

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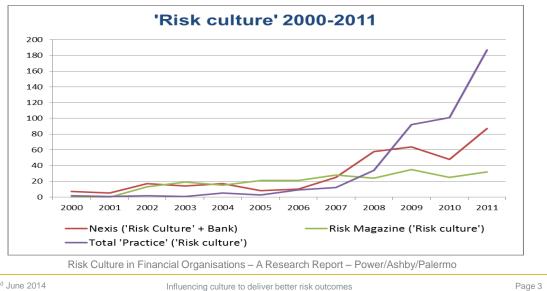| Section	Page
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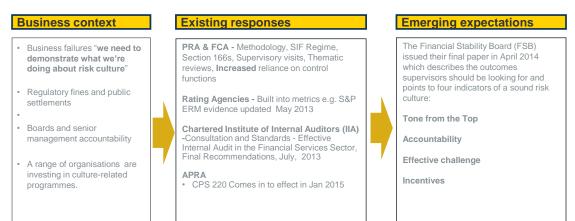2nd June 2014

1 Interest has grown enormously

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'Risk culture' 2000-2011

Legend:
- Nexis ('Risk Culture' + Bank)
- Risk Magazine ('Risk culture')
- Total 'Practice' ('Risk culture')

Risk Culture in Financial Organisations – A Research Report – Power/Ashby/Palermo

1 Risk culture is at the top of the regulatory agenda

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Business context	Existing responses	Emerging expectations
• Business failures "**we need to demonstrate what we're doing about risk culture**" • Regulatory fines and public settlements • • Boards and senior management accountability • A range of organisations are investing in culture-related programmes.	**PRA & FCA -** Methodology, SIF Regime, Section 166s, Supervisory visits, Thematic reviews, **Increased** reliance on control functions **Rating Agencies -** Built into metrics e.g. S&P ERM evidence updated May 2013 **Chartered Institute of Internal Auditors (IIA) -**Consultation and Standards - Effective Internal Audit in the Financial Services Sector, Final Recommendations, July, 2013 **APRA** • CPS 220 Comes in to effect in Jan 2015	The Financial Stability Board (FSB) issued their final paper in April 2014 which describes the outcomes supervisors should be looking for and points to four indicators of a sound risk culture: **Tone from the Top** **Accountability** **Effective challenge** **Incentives**

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1 What should firms be considering?

Financial services firms face three simple questions when addressing risk culture...	**To address these questions, financial institutions should consider the following actions…**

Financial services firms face three simple questions when addressing risk culture...

1
What is our risk culture?

2
What is this based on?

3
What are we doing about our risk culture?

To address these questions, financial institutions should consider the following actions…

1. **Defining** what risk culture means for your organisation
   ► Define a continuum of behaviours e.g. unacceptable, desired
   ► Identify and prioritise the mechanisms which influence employee behaviours
   ► Agree on an assessment approach e.g. combination of survey-based, process-based and customer-experience analysis methodologies

2. **Assessing** risk culture to determine what is it based on
   ► Identify areas of 'good' risk culture along with areas of potential vulnerability e.g. behavioural issues, mechanisms need strengthening to deliver desired behaviours
   ► Prioritise gaps and identify interventions
   ► Agree on on-going monitoring and/or assurance process

3. **Changing** risk culture through interventions
   ► Communicate and train desired behaviours
   ► Address immediate behavioural issues
   ► Strengthen the mechanisms that are designed to deliver the desired behaviours e.g. HR processes, risk appetite, risk governance

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2 Defining attributes of a "sound" risk culture

Risk culture can be defined as the demonstrated behaviours of employees that impact risk outcomes.

Leadership - Tone from the middle aligned with tone from the top and desired behaviours are established

Organisation - Risk governance and operating model support the delivery of desired behaviours and enable strong accountability and effective challenge

Risk framework - Risk management framework is embedded in the way the business manages risk and enable effective challenge

Incentives - Employee lifecycle and incentives support the delivery of desired behaviours

To deliver an appropriate risk culture, a variety of enablers need to be in place and be effective

Behavioural enablers

Incentives
Providing the right motivations

Leadership
Communicating the right message

Employee life cycle

Tone from the top

Rewards

Behavioural model

Risk Culture

Risk transparency

Roles and responsibilities

Risk appetite

Governance

Risk framework
Taking the right risks

Organisation
Establishing the right environment

Attitudes & behaviours do affect outcomes

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Signs indicating attitudes and behaviours may impact outcomes *positively*	Signs indicating attitudes and behaviours may impact outcomes *negatively*	Areas where attitudes and behaviours have most potential to impact outcomes *negatively*
► Corporate values promote good behaviours and stress the importance of risk management ► Actual behaviours are compared with desired behaviours and measured ► Staff understand what the values mean to them	► Overly dominant and deal driven senior leadership leading to pressure as to what is reported ► Personal pride / desire to feel in control by key individuals in the business	► New people in fast growing division
► Communication and escalation of issues is viewed as being pro-active and rewarded ► Consequences for inappropriate behaviours clear	► Intolerance of open discussions and challenge ► Lack of independent checks on key decisions ► Disregard for the views of the Risk community ► Business elevated over Risk and Internal Audit ► Controls are compliance driven / tick box	► Silo mentality ► Geographically 'remote' business ► New business outside the scope of core activities ► Business restructure
► Consequences for control breaches in place ► Percentage of issues identified by the business higher than those identified by Risk and Internal Audit ► Business MI includes risk information relating to business performance	► Failure to understand the profit drivers of the business and completing competitive analysis ► Unclear level or understanding of risk appetite tolerances ► Over confidence or unauthorised underwriting ► Ineffective escalation and fear of bad news	► Fast growing existing business
► Compensation is risk and behaviour adjusted in practice ► Promotional paths depend on behaviours ► Management provides business and support functions with appropriate level of risk resources	► Mis-alignment of incentives leading to desire to report good results to achieve bonuses ► Management recruited from single provider ► Long serving management and staff isolated from trends in the market	► Commission-based personnel

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3 ## Assessing risk culture – assigning responsibilities

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Board of directors
- Sets "Tone at the Top"
- Has overall responsibility to measure and manage the organisation's risk culture and delegates this responsibility to Management

Business units
- "Owner" of the firm's risk culture
- Responsible for the implementation of strong risk culture and report to the Risk Management function, Internal Audit and the Board on areas of concern

Risk Management Function
- Facilitates the design and implementation of the risk culture program assisted by HR
- Responsible for the independent oversight of the firm's risk culture
- Reports to the Board on issues remediation activities

Human Resources Function
- Provides thought leadership on Cultural change
- Supports Business Units and the Risk Management function for implementing the risk culture program
- On-going monitoring

Internal Audit Function
- Internal Audit is responsible for assessing the adequacy and operational effectiveness of the firm's risk and control culture
- Reports any issues to the Board's Audit Committee

4 Leadership – **Tone from the Top/ERM**

UNUM

- Risk's vision is to enable Unum to build a sustainable and competitive business where consideration of risk and capital is routine for all key business decisions.

- The corporate emphasis is an **agile risk culture** that demonstrates the widespread, consistent and effective use of the risk management framework's tools and techniques.

- Superior business performance by better understanding the drivers of risk; pricing to capital efficiency; quicker & more informed decisions.

Strategist	• ERM Principles & Framework • Emerging Risk focus • Capital Optimisation • Risk Culture – agile business decision making to optimise performance
Business Partner	•'Trusted Advisor – "Voice in the Moment" • Assurance – independent risk reviews • Challenge management reflecting market trends
Controller	•Embedding 1st line ownership of Risks & Controls •Effective utilisation of business tools e.g. Open Pages •Improved MI & analysis

4 Leadership – Agile Performance

UNUM

The most important part of a high performance racing car is its brakes. They control the power from its engine, save the tyres and fuel, optimising overall race performance.

we had strong race pace… and we pushed very hard to try to build up a gap. …If you don't pay enough attention it can go wrong pretty quickly. I focused on hitting the brakes correctly and on saving the tyres. We didn't expect to be that strong, but it's a team effort. Everyone is pushing hard and I think the secret, if there is one, is that we love what we do and we're so passionate."

4 Organisation   unum

Strategic Initiatives

➢ Pace of Change/Agility initiatives in 2013 linked to the 2012 WES survey

➢ 50 strong senior cadre of company managers to take more of a leadership role

Risk Appetite & Embedding ERM

➢ Greater candour within the organisation, evidenced by an increase in the number of significant risk events reported

➢ Expanded the suite of stress testing scenarios together with UK Board

➢ Strengthening the ERM framework, collaborating with Unum Group to align approaches and gain greater efficiencies

➢ Risk appetite focused on clearly defined measures, tolerances and limits, including forward looking data or indicators

Agile Governance

➢ Refresh and re-equip governance structure

➢ Greater focus on effective, key controls – Formula 1 link to Risk Management

➢ Embedded new Risk System, which captures data and enables the identification of trends

➢ ERM is increasingly embedded, with increased 1st line ownership of risk and controls

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4 Organisation – What others say   unum

Enterprise Risk Management: Adequate

• *Risk management is **embedded within Unum's culture**. The corporate business plan and the business plan for each division, both involve risk assessments. The UNUM board has responsibility for overall risk strategy. The board risk committee (RC) has responsibility for implementing the risk strategy agreed by the board. The RC delegates the implementation of the agreed risk strategy to the risk capital and solvency committee (RCSC).*

• *Risk analysis is an important part of decision-making process** and is **incorporated in the annual strategic and business planning process**. There is a **well-established risk governance structure** consisting of the RCSC and executive control champions for each business area. **Executive control champions** for the various business areas are required to **sign off on the risk and control profile for each business area** annually. Business areas produce **monthly risk reports and use performance indicators**, such as quantification of financial risk exposure, to monitor delivery of objectives.*

• *Unum's approach to **asset-liability matching is strong**. Its objectives are to achieve little to no durational mismatch, to diversify by sector within the asset portfolio, and to avoid undue concentration of holdings.*

• *Morbidity, which is the main insurance risk to which UNUM is exposed, is monitored regularly, and any adverse deviations or trends are fed back into the pricing/reserving process. Exposure to **concentration risk from the group life business is limited through reinsurance** with a strong lead reinsurer and by **regularly monitoring the concentration position**. Operational risks are captured across the company, and all business areas maintain risk profiles with risks scored on an **inherent (before controls) and residual (after controls) basis**.*

Management & Governance: Satisfactory

• *We consider Unum's management and governance to be satisfactory. We view the **management team as experienced and sound**. Strong customer service standards are maintained, which is a key part of Unum's competitive position. We note that management's strategic focus in the recent past seems to have shifted to achieving rate increases. Whilst **financial management is conservative**, the decrease in the target Pillar I coverage ratio can possibly indicate a somewhat increased financial risk tolerance.*

• *Source: Standard & Poor's Full Analysis Report (November 2013)*

Framework – Shift of gear

- **Simplification** - Developed and delivered a clearer Risk & Capital Management framework.
- **Strengthening** – Overhaul of governance framework - all key 1st line processes mapped to 2nd line governance
- **Shifting** – Greater day-to-day operational risk management decisions back into business divisions through Risk Owners and Control Owners.
- Risk Function is more focused on the forward looking view of Emerging Risk, collaborating with Actuarial to understand capital implications of changes to the risk profile.
- Risk Team are also undertaking more work as a trusted adviser.
- Risk challenging large control universes to identify those which are now redundant – Greater focus on what controls really matter (80/20 rule).
- A new Risk System, IBM Open Pages, has also been introduced industrialising older record systems aiding data quality capture and making it easier to identify trends.
- Allow greater emphasis on three key themes:
    - **Ownership**
    - **Focus on things that matter**
    - **Urgency**

Framework – Evidence its working

- The embedding of Risk Culture has been evidenced by a number of activities:
    - **Increase in the number of Risk Events reported**. Not seen as negative but an indication of greater risk awareness.
    - **Volatility Management Framework**– Placing volatility in a risk vs. reward context.
    - **Target Operating Model** – Proof of concept initiatives, End 2 End teams. Optimising business processes.
    - **Test and Learn Initiatives** - Trying new ways of doing things. Quickly ruling changes in or out.
    - **Agile Project Management** – Swift 80/20 results capture and move on.
- Supporting activities
    - Expanded the suite of stress testing scenarios
    - Board role & Executive role play exercises
    - Engagement with external stakeholders.

4 Incentives – 7 effective habits

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1. Revisions to performance management process to reflect "new" culture

2. "Ownership" and "Leadership" theme emphasis

3. External recruitment at a senior level to refresh the talent pool

4. Market testing of package structures for Executive and other Key Decision Makers - fixed vs. variable compensation and short vs. long term reward

5. Annual alignment of Sales Incentive Plans to current strategy

6. Review of compensation setting process and short vs. long term balance for 2nd & 3rd line functions

7. Candid speaking reward initiatives

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5 Risk culture programmes - What is your firm doing?

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A number of key activities across your organisation can help strengthen your risk culture					

	Define and assess risk culture			Strengthen and sustain risk culture		
Step	Defining risk culture	Assessing risk culture	Benchmarking and reporting	Changing risk culture through interventions	On-going monitoring	Assurance process
Activities	► Behaviours definition ► Behaviours to mechanisms mapping ► Minimum baseline and aspirational targets ► Risk culture indicators definition and sourcing ► Roles and responsibilities	► Survey development and implementation ► Risk culture incidents ► Evidential review of mechanisms e.g. HR, risk, governance systems ► Self assessments ► Behaviours through structured interviews	► Across businesses, regions, against regulatory expectations, industry practices ► Feedback to business, management, Board ► Thematics and detailed findings ► Heatmap, dashboard	► Areas of potential interventions: – Risk Management: frameworks, appetite, – Compliance monitoring – Governance and organisational structure – Operations and controls – HR: Performance, L&D and reward – IT infrastructure	► Risk culture indicators analysis ► Triggers for action ► On-going risk culture assessment, benchmarking and reporting ► Tracking risk culture change	► Audit of risk and control culture: – Planning – Organisation-wide assessment – Within each audit – Targeted audits of high-risk areas
Outputs	• Behavioural framework: with clear mapping and alignment of values to day to day behaviours, defining minimum and aspirational behaviours	• Robust analysis of the 'as is' risk culture through behavioural and mechanism assessments, providing clear evidence of the current culture	• Early identification of culture 'hot spots' across the business through identifying undesirable risk culture outcomes	• Practical, prioritised initiatives to drive the greatest impact to behaviour change, linked to other initiatives such as Conduct, Reward etc	• Ongoing monitoring tools for firms to monitor progress independently	• Sustainable assurance methodology

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Thank you

Neal Writer
Senior Manager – EY Risk & Actuarial Services
NWriter@UK.ey.com Telephone 0207 951 7028

Kevin Borrett
UK Head of Risk – Unum Ltd
Kevin.borrett@unum.co.uk Telephone 01306 873223