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# Moving the Risk Function into the future

Nick Dexter



04 November 2013

## Moving the Risk Function into the future

- The Market /Regulatory Environment
- Clarity of roles v the business
- Integrated Assurance
- Improving Risk Efficiency



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## Market environment



Market challenges	What risk functions are doing
Low interest rate environment	Improving risk efficiency
Continued Eurozone volatility	Leveraging the ORSA
Intrusive proactive regulatory focus	Focussing on regulatory relationships
Driving operational efficiency	Streamlining operations
Developing focus on conduct	Adapting to maturity



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## What is the Regulatory focus?



Regulator	FCA	PRA
Objectives	Good customer outcomes	Viability, sustainability, and the management of model vulnerabilities
Tools	Thematic reviews and Business Model and Strategy Analysis	Thematic reviews and Business Model Analysis

Both regulators view **business model analysis** as a critical part of their regulatory regimes.

### PRA/FCA governance areas of focus

Clear delegation of authority and articulation of committee responsibilities

Oversight of Risk, Compliance, Internal Audit, Actuarial functions

Evidence of good culture and behaviour e.g. 'tone from the top'

Challenge MI and reporting (including ORSA report), escalation of issues from committees



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## The developing accountabilities of the CRO

Challenging the business strategy

Oversight and challenge of firm wide risk management, systems and controls

Oversight and validation of external risk reporting

Monitor and reporting on risk appetite versus risk profile



Think the unthinkable



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## Corporate governance

- Corporate Governance has evolved over time and more recently has come under closer scrutiny from Supervisors and external stakeholders

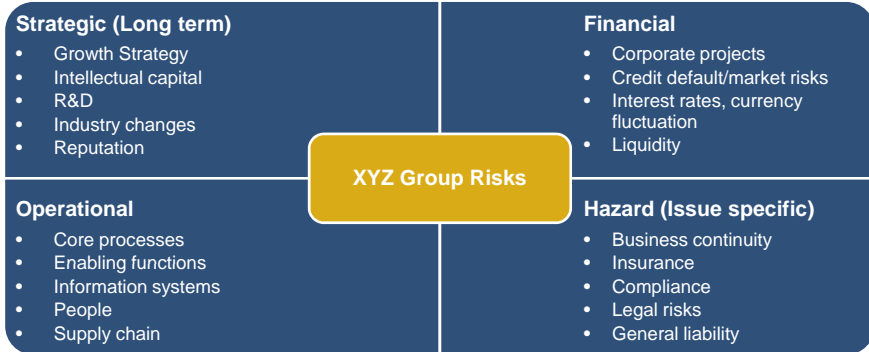


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## What are we seeing elsewhere?

- Risk management at a multinational Mining Group



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## The Risk Function into the future

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## Guiding Principles for the Risk Operating Model

Potential Guiding Principle	Example Outcomes
1 <b>Protects participants and sustains mission</b>	<ul style="list-style-type: none"> <li>■ Employees at all levels act in a 'risk responsible' manner,</li> <li>■ Board and executive management team foster a company-wide risk culture.</li> </ul>
2 <b>Enables strategic objectives</b>	<ul style="list-style-type: none"> <li>■ Risk appetite is aligned with strategy and offers clear guidance for determining strategic trade-offs.</li> </ul>
3 <b>Preserves and optimises capital</b>	<ul style="list-style-type: none"> <li>■ Rigorous application of risk management and financial prudence</li> </ul>
4 <b>Provides competitive advantage and drives business results</b>	<ul style="list-style-type: none"> <li>■ Best-in-class risk analytics system and tools</li> <li>■ Informed risk taking is integrated into corporate processes and day to day business decision making enabling better outcomes.</li> </ul>



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## Guiding Principles for the Risk Operating Model (cont.)

Potential Guiding Principle	Example Outcomes
5 <b>Is adaptable</b>	<ul style="list-style-type: none"> <li>■ Risk management practices evolve to meet company's changing needs</li> </ul>
6 <b>Is both effective and efficient</b>	<ul style="list-style-type: none"> <li>■ Consistent corporate-wide approach to reporting and managing risk that includes:               <ul style="list-style-type: none"> <li>– Common risk and control taxonomy and policies</li> <li>– Efficient use of resources and skills to meet businesses needs.</li> <li>– Streamlined risk reporting.</li> </ul> </li> </ul>
7 <b>Is forward-looking</b>	<ul style="list-style-type: none"> <li>■ Forward-thinking risk team provides expertise, advice and direction on risk management to senior business leaders.</li> <li>■ Emerging risks identified and multiple management scenarios are considered</li> </ul>

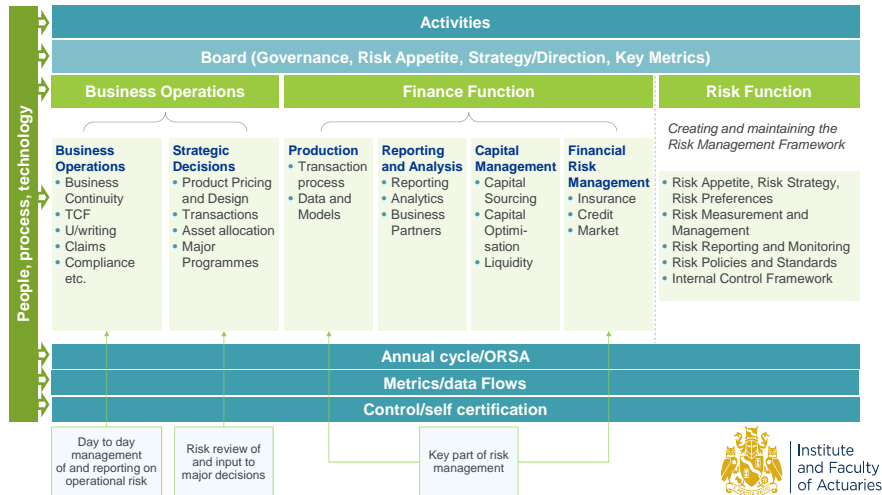


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Create Note: version 2

## Defining the Target Operating Model for an effective Risk Management organisation

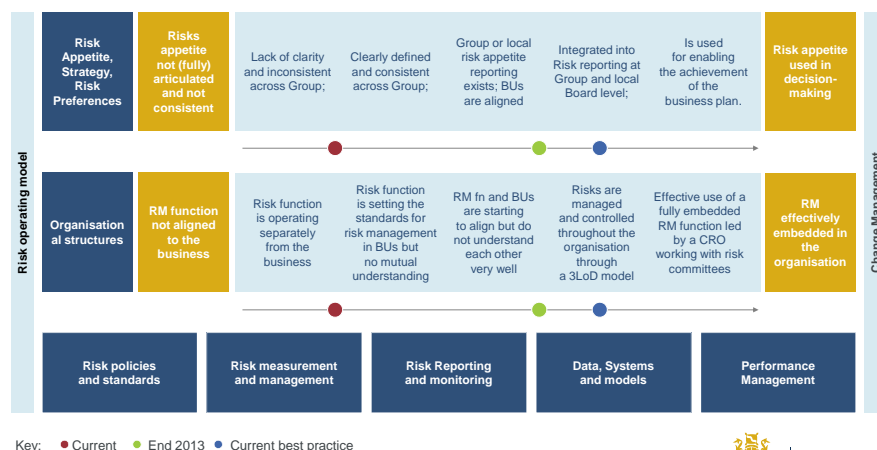


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## Risk Target Operating Model

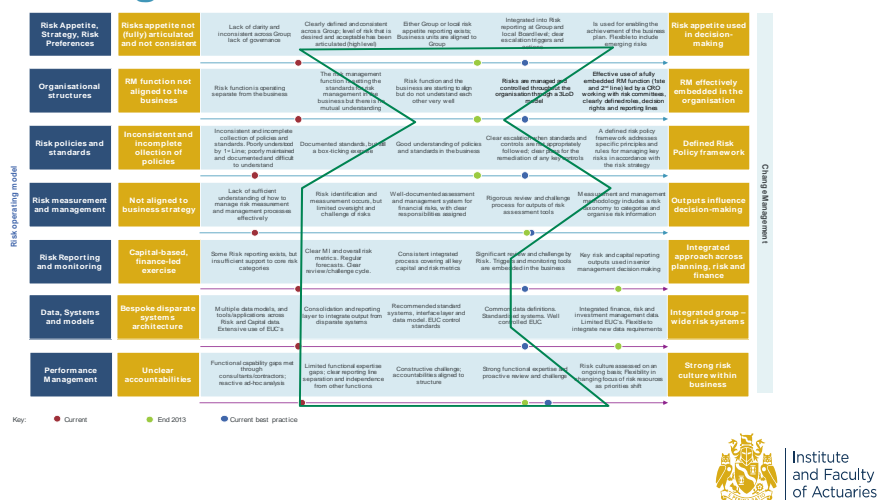
Setting the vision – Risk



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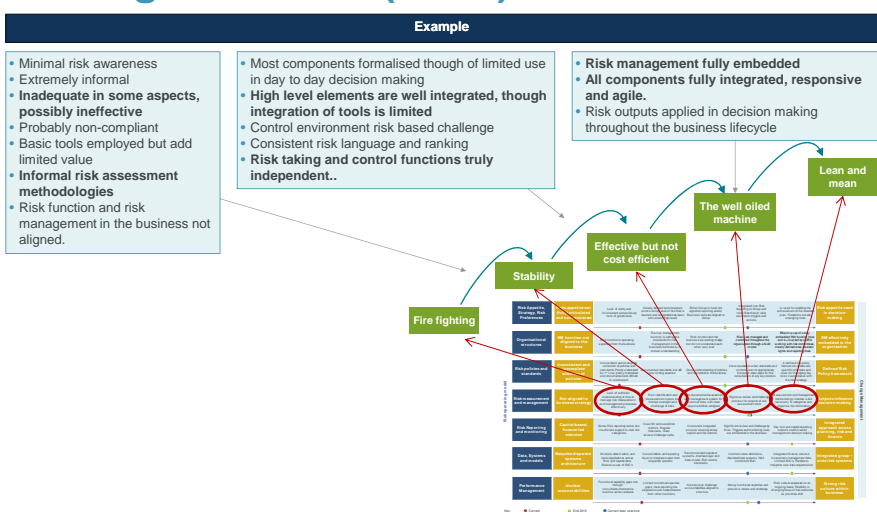
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## Risk Target Operating Model Setting the vision



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## Risk Target Operating Model Setting the vision (cont.)



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## Organisational design

### An 'architect' role in driving risk management effectiveness

PGT Note:  
Ideally  
should be  
split so text  
can be read?

Capability Development	Information and Metrics	Functional Control and Authority	Roles and Responsibilities	Communication and Messages	Performance Management and Reward	Leadership and Direction	Strong processes and controls
<ul style="list-style-type: none"> <li>Tailored Competency frameworks (technical/business skills).</li> <li>Practical and tailored training for the business community – technical and behavioural.</li> <li>Ensure baseline requirements are met according to the FSA requirements for approved persons.</li> <li>Rotation of staff between risk and the business</li> </ul>	<ul style="list-style-type: none"> <li>Defined ways of working between the Risk Function, the finance function and the Business Community.</li> <li>Risk providing policies in business language to the business.</li> <li>Process for continuous interaction: monitoring, feedback and review.</li> </ul>	<ul style="list-style-type: none"> <li>Functional independence.</li> <li>Delegated and transparent authorities.</li> <li>Clearly defined framework.</li> </ul>	<ul style="list-style-type: none"> <li>Clearly defined individuals roles within the three Lines of defence.</li> <li>Clearly defined personal accountability and responsibility for compliance management in individual roles.</li> </ul>	<ul style="list-style-type: none"> <li>A communication strategy that embeds ownership through ongoing awareness of recent developments and adoption a common language.</li> <li>Clear and consistent messaging in a language that is understandable for the business.</li> </ul>	<ul style="list-style-type: none"> <li>Monitor, measure and incentivise through the performance management system.</li> <li>Clear line of sight between strategic objectives and individual performance objectives.</li> <li>Penalties for poor performance are seen to be significantly impactful.</li> </ul>	<ul style="list-style-type: none"> <li>Risk management is clearly articulated in the strategy, vision, mission and values.</li> <li>Develop Leaders to display 'Good Risk Leadership'.</li> </ul>	<ul style="list-style-type: none"> <li>Clear instructions and guidelines on key risk management processes, parameters and procedures.</li> <li>Clear reporting</li> <li>Two way feedback lines</li> </ul>

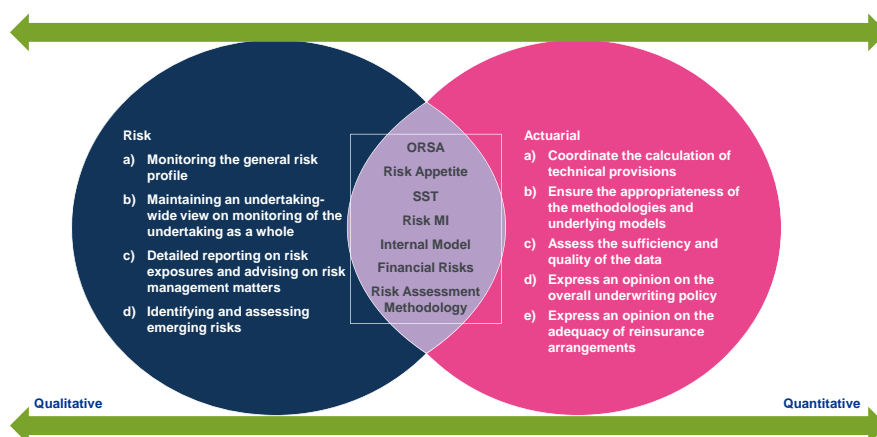


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## Risk and Actuarial: FLAOR / ORSA Example



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## The Risk Function into the future

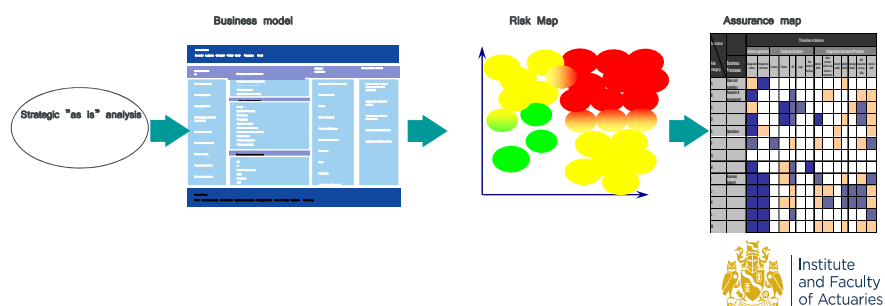
- The Market /Regulatory Environment
- Clarity of roles v the business
- **Integrated Assurance**
- Improving Risk Efficiency



## Integrated assurance

### Development framework

- In most cases the plan will be developed from a clear understanding of :
  - the company's strategic objectives,
  - the business model (including key business processes) for delivering those objectives and
  - the risks associated with these.



## Integrated assurance map

Example



## Integrated assurance - Lessons Learned

- One size does not fit all
- Evaluating and rationalising risk framework requirements
- Standardising local operational implementation
- Assurance plans driven by specific control environment as well as key risks
- Central function planning and co-ordination of assurance activity
- Setting the internal control environment and key control expectations centrally
- Embedding risk and assurance teams throughout the business
- Keep it simple

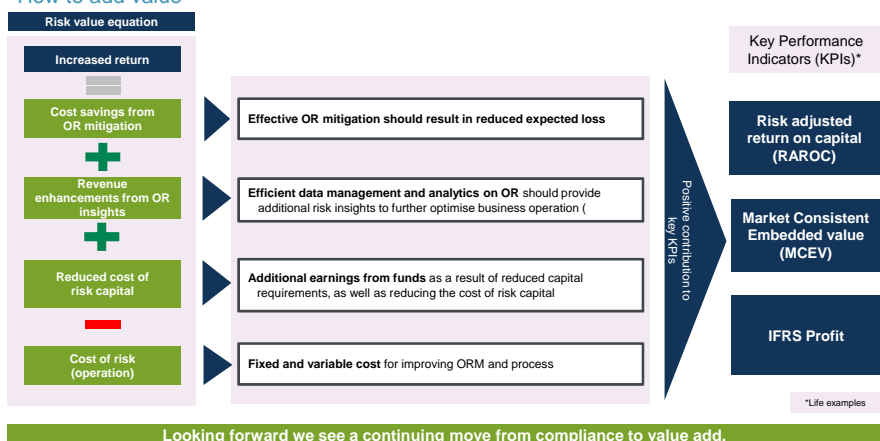
## The Risk Function into the future

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## Improving Risk Efficiency

How to add value



## Improving Risk Efficiency

How to add value

The risk value equation would need to be assessed and considered in its totality

		Risk Value Equation				
		Cost savings from risk mitigation	Revenue enhancements from risk insights	Reduced cost of risk capital	Cost of risk (operation)	Positive contribution to RAROC, MCEV or IFRS profit
1	Operating Model ORM TOM and appetite framework are aligned to the business plan	↑	=	=	↓	+
2	ORM processes Further integrate the ORM component processes with its capital assessment processes	↑	↑	↑	↑	+
3	Reporting Mechanism Fit for purpose OR MI to allow effective and improved analysis.	↑	=	↓	↓	+

Cost Benefit Analysis to help establish benefits versus cost over a certain timeframe



## Contact

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# Prudential UK Risk Function

November 2013

**Michael Bartholomeusz**  
Director of Regulatory and Conduct Risk



## Agenda

1. Risk – an external perspective
2. Risk Culture
3. Prudential UK Risk Management Model
4. Prudential UK Risk Structure
5. Regulatory Change and impact
6. Current Risk focus
7. Conduct Risk
8. Summary
9. Questions and comments



## Risk – an external perspective



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## Risk Culture

Many descriptions...try these:

“In a risk business, risk is everyone's business”

and/or

“Risk considerations prevail when no-one's looking”



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## Risk Culture – what good looks like

- Strong executive tone from the top via high quality dialogue supporting risk management and its resourcing
- **Visible support from the top to formal development of risk capabilities and tools**
- Risk appetite and risk capacity are key components of strategy development and business planning
- **Openness and active ownership by 1st line of risk management, 2nd line have unfettered access to all parts of the business and are invited into business areas' strategic and management discussions at an early stage**
- Risk management practices are streamlined to be both commercially oriented and designed to meet regulatory expectations, thereby seen to be offering competitive advantage
- **Risk appetite, measures and limits are consistent, cascaded, well understood and respected across the firm**
- Risk management high on business agenda at all levels, open and documented approach to lessons learned
- **Responsibilities for different aspects of risk management are clearly and consistently understood between the lines of defence at all levels in the organisation as relevant to the roles people play**
- Strong two way risk communication and open constructive challenge exists across the lines of defence. Acceptable to agree to differ
- **Risk based escalations clearly understood at all levels across the firm, operate freely with multiple routes, when appropriate, in a timely and orderly fashion**
- Risk performance and development are key parts of staff appraisals and overall performance management – risk underperformance is not accepted



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## Risk Management Model



- Prudential UK operates the 3 Lines of Defence Model
- This places risk management responsibility firmly within the business
- Risk is the 2<sup>nd</sup> Line function, guiding, challenging, overseeing and assuring the operation of the business



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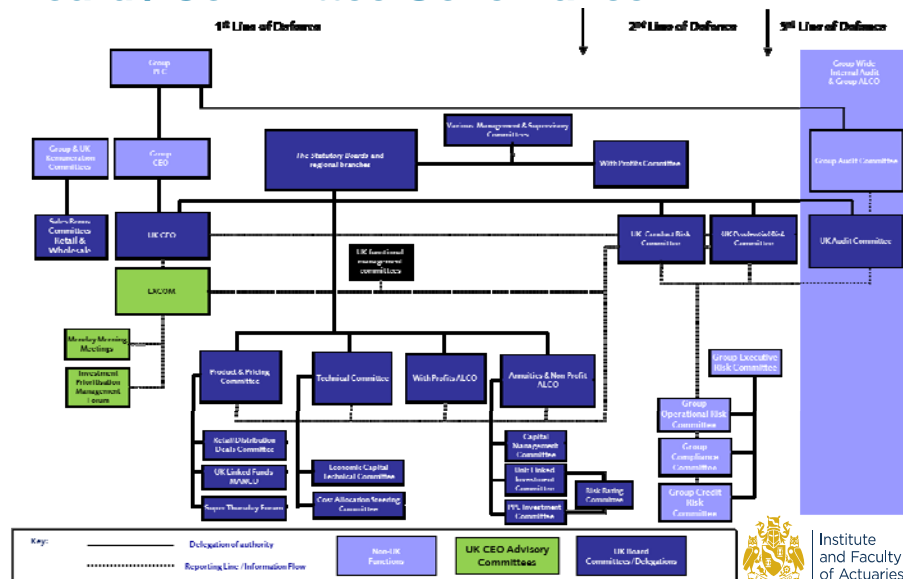
## UK Financial Regulation Post FSA



Consumer interests rule, subject to minimum solvency levels

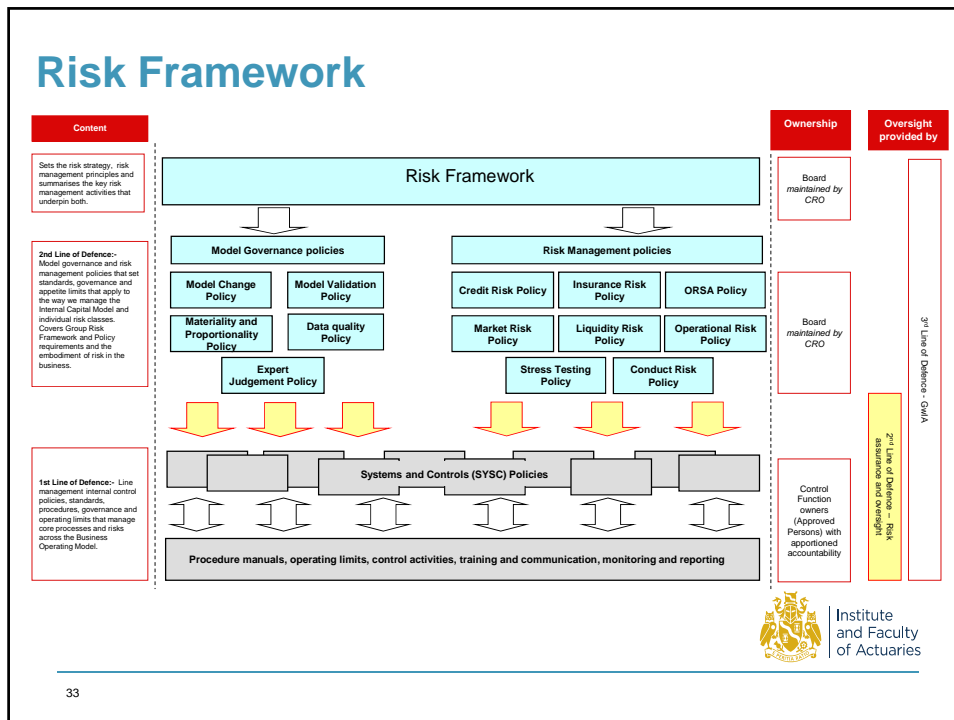
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## Board / Committee Governance

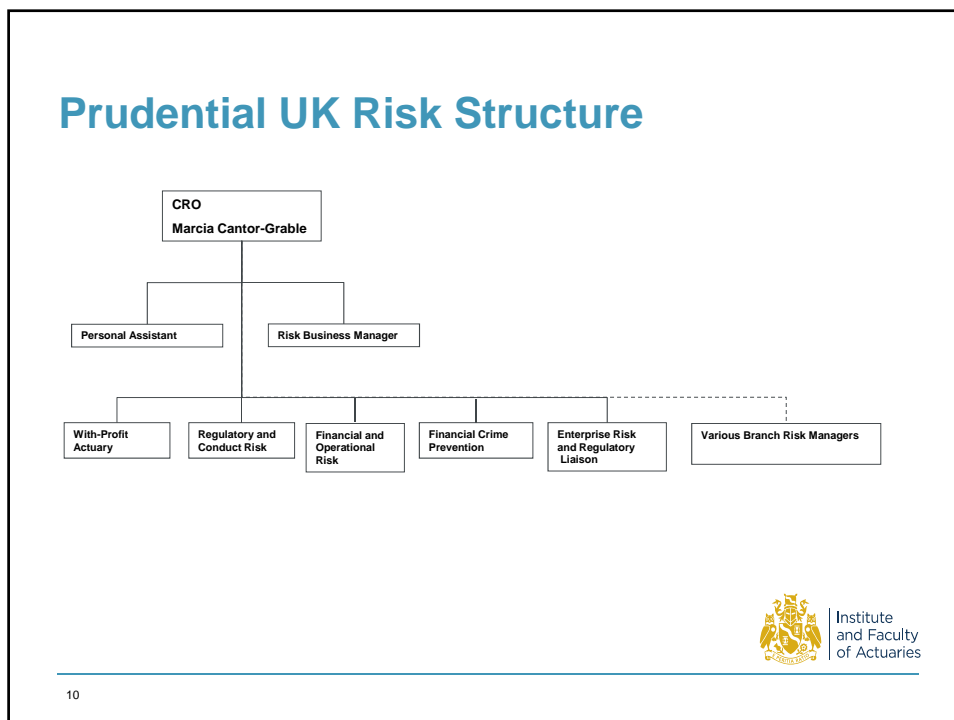


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## Risk Framework



## Prudential UK Risk Structure



## Impact of Regulatory Change

- Changes precipitated by split of FSA into prudential (PRA) and conduct (FCA) regulators:
  - Focus on **end-to-end business model** analysis and drivers, which **drive customer outcomes**
  - Business model key areas:
    - Financial: performance targets
    - Strategy: markets, propositions, products, target customers, distribution channels
    - Infrastructure: business processes, technology platforms, organisation structures, governance
    - Behavioural: people and culture, measures and incentives



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## Impact of Regulatory Change

- Major extension to responsibilities of the Compliance Function under Solvency II
  - Includes advising the Board on compliance with the laws, regulations and administrative provisions adopted pursuant to the Directive e.g.
    - Prudential aspects
    - Internal Model
      - Governance: Oversight, Validation, Data Quality, Model Change, Materiality and Proportionality, Expert Judgement
    - Conduct aspects
- Volume of other regulatory change (including tPR, HMRC, ICO etc.)



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## Current Risk focus

- Increased Risk involvement in Strategy and Business Planning
- Further development of Risk Appetite – Conduct and Prudential
- Conduct Risk development
- Embedding SII into BAU
- Model Validation further improving linkage between Actuarial and Risk Function
- ORSA evolution
- Demonstrating Risk Culture
- Governance further development
- Support to NEDs
- Preparation for GS-II
- Regulatory relationships



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## Conduct Risk

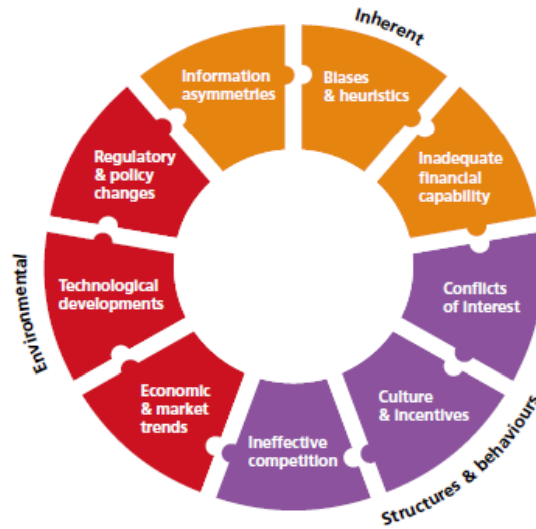
- **Conduct Risk**
  - Arising from the approach taken by firms in their relationship with customers
- **Conduct Risk Appetite**
  - The quantity that a firm is willing to tolerate in the execution of its conduct risk strategy
- **Conduct Risk Strategy**
  - A plan of action across the organisation to manage conduct risk
  - Including identification, prioritisation, assessment and control



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Source: based on KPMG material

## Conduct Risk drivers



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Source: FCA Financial Risk Outlook 2013

## How Does Conduct Risk Differ From TCF?

### FCA Performance Measures

Orange boxes indicate where Conduct Risk scope is broader than TCF

### Measuring our performance



#### Notable points:

- Value for money considerations are new and as yet not well-defined, though competition and profitability are likely important factors. Firms and products which generate "outlier" high margins will be a focus of attention
- Customer service is within the scope of Conduct Risk whereas it has not been considered a fairness issue per se under TCF



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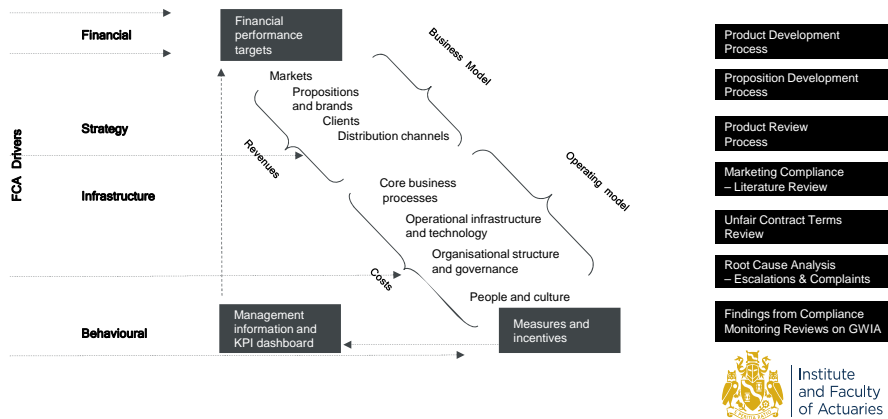
Source: Journey to the FCA published October 2012

## Conduct Risk – Business Model Analysis

Conduct risk assessment focus on **4 key areas**:

**Financial, Strategy, Infrastructure, Behavioural**

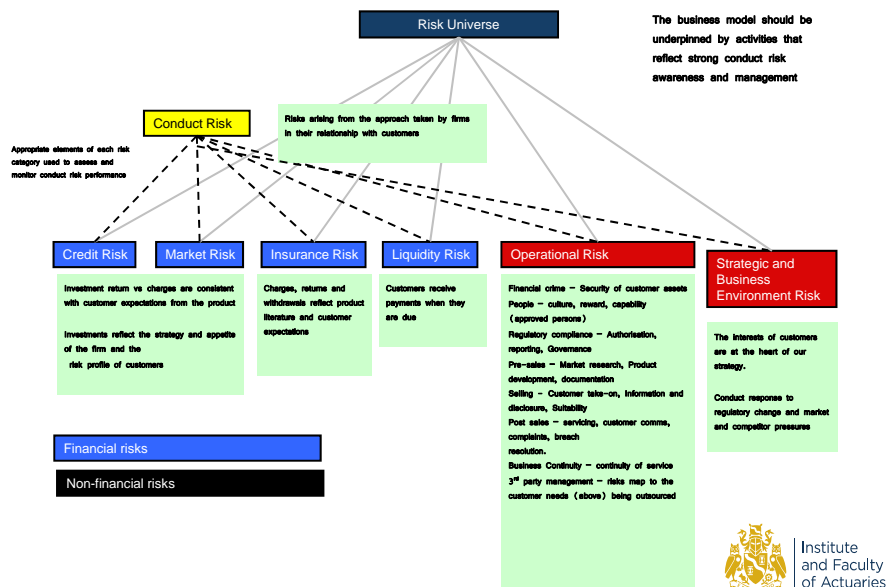
Across the end to end business and operating model, this is likely to focus on the following areas:



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Source: based on KPMG material

## Conduct Risk Lens on the Risk Universe



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## Summary

- Risk Function evolving to meet changing stakeholder demands
- Regulation is the current biggest driver
- Strong Risk Culture and Governance even more critical
- Solvency II – Pillar 2 into BAU
- Conduct Risk – “the new kid on the block”...and Risk hot topic
- FCA expanding TCF to an all – encompassing level
  - Behavioural Economics
  - Customer vs. Firm perspectives
  - Business Model and Risk Framework implications
  - How to quantify?

## Questions and comments



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# Questions

# Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.



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