

Making Strategic Risk Management Work

Introduction

Introduction

- Turn your concept of risk identification on its head
- Introduce “systems” concept and some tools from other disciplines
- Explain a cutting-edge approach to identifying your real risks
- Is this the missing piece of the jigsaw for ERM in Financial Services?
- A glimpse of future developments

Making Strategic Risk Management Work

Neil Allan
University of Bath
School of Management

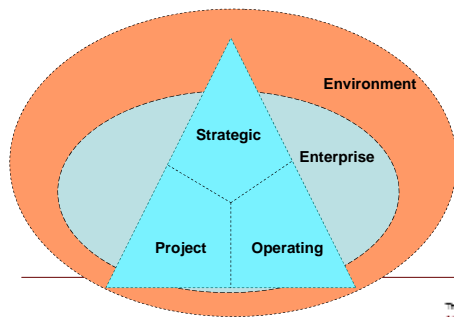


The Nature of Strategic Risks

- "...they tend to be less easy to spot, more disruptive, less easy to quantify and often less stable" OGC & SUCO
- "...they are at once pervasive and inter-related" & "effective organisational control structure is essential" Economist/Arthur Anderson
- "...an array of external events and trends that can devastate a company's growth." Slywotsky & Drzik (2005)
- "Strategic risks are the system of opportunities or threats that initiate a process that can significantly transform the enterprise's purpose" STRATrisk Dti/ICE/Actuarial Profession

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*Strategic risks are the system of **opportunities or threats** that initiate a process that can significantly transform the **enterprise's purpose***



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Principals for Strategic Risk Management

- People
 - Strongly linked to people, behaviour and culture - Individual behaviour at heart of most strategic risk
- Perception
 - Experience, learning and openness important
- Process
 - Dynamic complex processes rather than static events
- Patterns
 - Appear random, chaotic and unpredictable - but usually indications of problems brewing
- Performance
 - Needs to be cogently linked to organisational purpose
 - Nearly all companies realise they need to get better

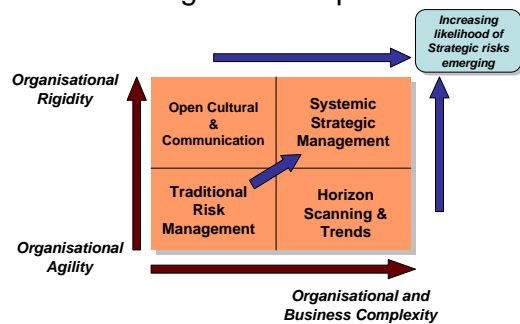
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How are Strategic risk different

- | | |
|--|--|
| <ul style="list-style-type: none"> ▪ Project/Operational Risks ▪ Singular events ▪ Many of the risks are known or are knowable ▪ History based on experience and repeatability ▪ Clear metrics ▪ Can be easily broken down into discreet events ▪ Individual risks can be owned and managed | <ul style="list-style-type: none"> ▪ Strategic Risks ▪ Dynamic and adaptive ▪ Unpredictable & high degree of uncertainty ▪ Process requires communication with people outside the organisation ▪ Process heavily dependant to people's behaviour ▪ Multi-variant, and interconnected ▪ Difficult to assign risk |
|--|--|

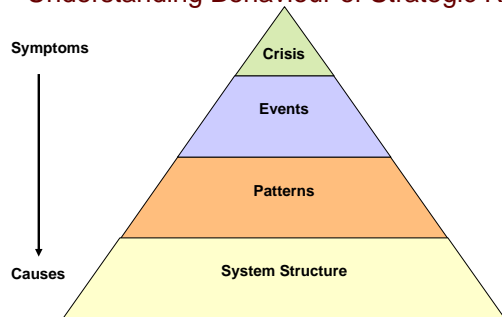
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Risk Management Emphasis



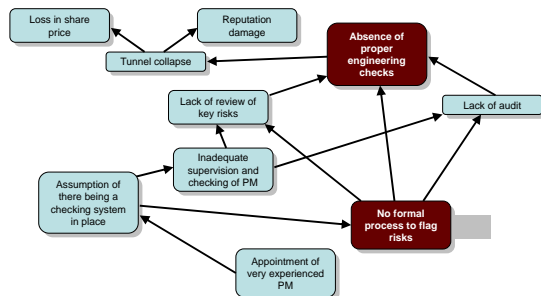
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Understanding Behaviour of Strategic Risks



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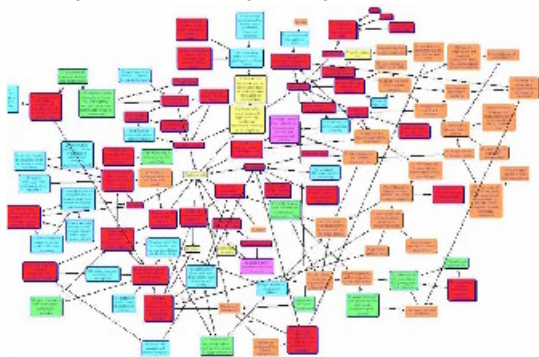
Example of Concept Mapping



Case Study 1 – Tunnel Collapse

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Example of Concept Map



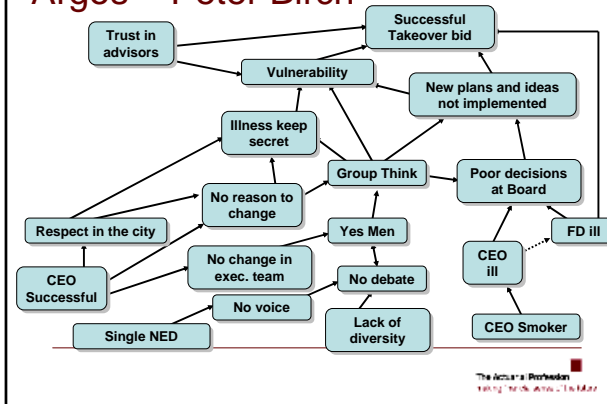
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Peter Birch

Make change early - Argos

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Argos – Peter Birch



How does this approach help?

- Enables thinking about process & systems rather than events
- Identification of patterns of fermenting risks and underlying structure
- Allows understanding of interrelationships, not snapshots of events
- See how to create opportunity from perceived emerging risk
- Simple communication tool, individual or group

Key Recommendations

- Strategic risks are complex adaptive systems
- Need to take holistic, systems approach
- Soft systems tools provides the rigour for pattern identification
- Concept/cognitive mapping shows great promise for understanding structure of systems
- This approach must be led by the Board to create appropriate culture

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Neil Cantle
Milliman



Strategic Risk in Financial Services

Strategic Risk Management is about:

- Competitive advantage
- ...through superior management of risk

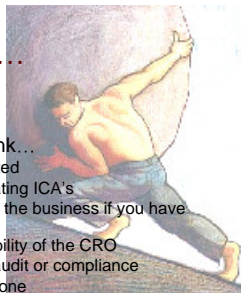
Meaning better:

- Capital efficiency
- Operational efficiency
- Resilience to external influences
- All arising from better understanding about risk exposure

Perceptions about risk...

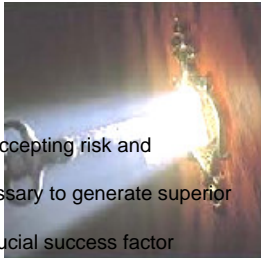
- A lot of companies currently think...
 - Risk is bad and should be eliminated
 - Risk management is about calculating ICA's
 - Risk management is *embedded* in the business if you have "risk registers"
 - Risk management is the responsibility of the CRO
 - Risk management is like internal audit or compliance
 - A quantified risk is an understood one
 - A complex risk model gives better understanding

- Ultimately risk is seen as an overhead



But really...

- Financial Services is about accepting risk and managing it professionally
- Intelligent risk-taking is necessary to generate superior returns
- *Understanding* risks is the crucial success factor
- "Fatal" events were not normally on risk registers
- *Risk management* is a trendy way of describing what lots of people already do every day
- Good risk management is a competitive advantage



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Root cause...



"...management problems appear to be the root cause of every failure or near failure, so more focus on underlying internal causes is needed..."

"...further analysis showed that these causal chains began in each case with underlying internal causes, being problems with management or shareholders or other external controllers; these problems included incompetence or operating outside their area of expertise, lack of integrity or conflicting objectives, or weakness in the face of inappropriate group decision..."

"Mathematical models are not a complete solution for effective risk management and firms' senior management should also ensure that they are incorporating risk management into the day-to-day operations of their firm."

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Just do the numbers ?

"Given that a firm's own assessment of the risks of its business is the engine that drives ICAS, it follows that we have a keen interest in the underlying risk assessment and management being sound, and of course that firms are using the results of the capital assessment to prioritise risk management spending and activity."

... some of the areas we intend to focus on include:

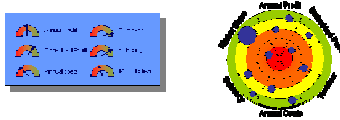
- engagement by the board and senior management;
- the strategic planning process and whether this takes account of risk assessment and mitigation;
- management information on identified and crystallised risks and associated controls;
- whether risk-based capital assessments are guiding capital spending and capital allocation within the business; and
- whether appropriate systems are used to hold and analyse risk management information."

Source: Westminster & City: Rethinking Life Insurance, Sarah Wilson 26th April 2006

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To make risk work...

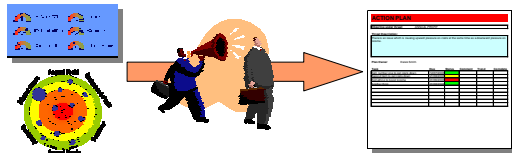
- Engage the Board – risks have to be related to business objectives



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To make risk work...

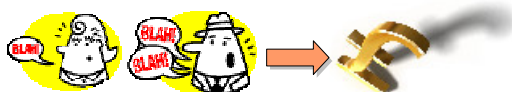
- Engage Management – *talk* about risk must lead to **actions** related to business objectives



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To make risk work...

- Engage Staff – all levels of the business have to speak fluently about risk drivers and appetite
- For all involved, the cost/effort of telling someone about risks has to be worth it



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Business Planning

- Interesting returns means taking risks
- Plan to reflect uncertainty
- Risk adjusted Strategy
- Understanding improves resilience
- **Strategic Risk Awareness**
 - Exploit areas of risk you manage better
 - Avoid areas you don't
- Better prioritisation of scarce resource

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Operational Activity

- Everyone is a risk manager
- Raise awareness of risk types you are/not prepared to take
- Share knowledge to reduce risk
- Enables "Heuristic" controls
- Ask (the right) questions
- **Strategic Risk Awareness** enables
 - Controls to be placed early in the causal chain of events
 - Faster responses when risk events happen

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Risk Capital

- Regulatory capital based on risk
- Rewards organisations for understanding of their key risks
- STRATRisk improves understanding
- Must be based on understanding of risks and actions
- Better understanding improves capital efficiency and may improve operational efficiency
- Align capital with strategic objectives

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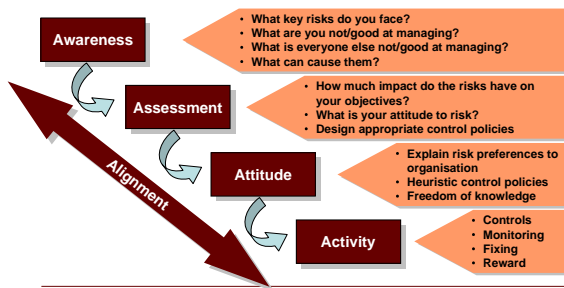
**COMPETITIVE
ADVANTAGE**

Risk Capital

- Strategic Risk Awareness...
 - Improves understanding of which risks to assess
 - Improves quality of exposure estimates
 - Ensures linkage between planning and capital
 - Embeds risk into planning and decision-making
 - Helps to avoid missing "the big risk"
 - Helps optimise operational and capital efficiency

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Strategic Risk Awareness



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Summary



Summary

- Risk management is about optimising your ability to hit **key objectives**
- Research shows that **understanding** your risk environment makes you more resilient
- Risk events normally arise from “**people**”
- Traditional models look at risk **events** – little/no warning
- Modern tools from other sciences can improve **Strategic Risk Awareness** in Financial Services
- Strategic Risk Awareness is a competitive advantage

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Future Developments

- Further research into qualitative tools to spot emerging patterns more quickly
- Industry benchmarking (if you are interested?)
- Further development of predictive quantitative tools

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QUESTIONS ?

Contact Details:

Neil Allan
n.d.allan@bath.ac.uk
01225 384507



Neil Cantle
neil.cantle@milliman.com
020 7847 6180