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Insurance Insights

Risk Culture: Not a tick-box exercise

Findings from a survey of the UK Insurance Industry

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INTRODUCTION

On the surface, there appears to be industry-wide recognition of the principle that an embedded, positive risk culture is important to reap the full benefit of Solvency II. However, practice indicates more of a 'tick box' attitude to risk, which means that insurers are set to miss out on the opportunities presented by this new regulation. This strategic risk myopia, some would argue, is attributable to the fact that the industry has tended to focus on Solvency II for its own sake, rather than on the benefits that could be derived from all the investment poured in, especially in risk management practices. This gives rise to some key questions:

- How important is it to set the 'right' tone-at-the-top within insurance firms?
- How can this be shifted from one of 'compliance with regulation' to one of a 'reward-yielding risk culture'?

To gain further insight into these issues and to develop a deeper understanding of the challenges around risk culture faced by the insurance industry, Protiviti conducted a survey among UK insurers, over March and April 2012, exploring these issues:

- The meaning and significance of an enabling risk culture;
- The extent of board involvement in risk-critical business activities; and
- The 'blur' of responsibilities across a number of risk-relevant functions.

Respondents included around 30 UK insurers representing all segments within the insurance industry, from composite insurers to bancassurers, with a number of life and non-life (both multiline and monoline) insurers in-between. To further pursue the dialogue and to obtain additional commentary on the responses received, the survey results were also discussed with a number of chief risk officers (CROs) and heads of risk, at Protiviti UK's regular CRO dinner forum.

We at Protiviti would like to thank all of the participants for their time and contributions to our survey. We hope this survey will be of interest to your organisation and we welcome your feedback on the survey results.

Protiviti
June 2012

TABLE OF CONTENTS

EXECUTIVE SUMMARY – RISK CULTURE: NOT A TICK-BOX EXERCISE.......... 3

DETAILED SURVEY FINDINGS AND ANALYSIS.......... 4

IMPLICATIONS FOR INSURERS.......... 15

SUMMARY – A CALL FOR ACTION.......... 16

METHODOLOGY AND DEMOGRAPHICS.......... 17

ABOUT PROTIVITI.......... 18

EXECUTIVE SUMMARY – RISK CULTURE: NOT A TICK-BOX EXERCISE

In the wake of the financial crisis back in 2008 and wholesale regulatory overhauls, such as Solvency II, more emphasis has been placed on the management of risk within financial services organisations, including insurers. One of the elements of an organisation's risk management framework that is increasingly receiving a significant focus is its risk culture. However, a spontaneous question ensues: What is meant by risk culture? A definition from the FSA runs along these lines: "… a firm's risk culture encompasses the general awareness, attitude and behaviour of its employees to risk and the management of risk within the organisation."

One might extrapolate, therefore, that risk culture is:

- A vital component of the overall effectiveness of risk management frameworks and practices; and that:
  - the extent to which employees understand and accept that risk management is a part of everyone's role and responsibility as they pursue their own goals and objectives.

Consequently, the importance of aligning risk culture with an organisation's risk management framework and practices cannot be underestimated!

Against this backdrop, the main highlights of the findings from the Protiviti survey are:

- Almost two-thirds of respondents (64 percent) report that CROs or heads of risk are still absent from the boards of their respective organisations.
- Overwhelmingly, respondents (68 percent) deem the risk function in their respective organisations to be a regulatory requirement and, at the same time, a necessary control function. In fact, more than one-third of those who were interviewed or who completed the online questionnaire attribute regulation as the primary driver of risk management practices across the insurance industry.
- Only 21 percent of respondents actually perceive risk management as a value-adding management and operational process resulting in business benefits.
- In addition, as further corroboration of what appears to be the prevalent mindset that risk management is a regulatory requirement, only 14 percent of those surveyed highlighted that their risk function does get involved in strategy formulation, business planning and capital management.
- Most respondents do not describe their risk management framework as mature, and least of all as 'embedded' in the business nor as aligned with their organisation's risk culture.
- Challenge from non-executive directors on the organisation's approach to risk management (46 percent) and the frequency and quality of board discussion on risk management (54 percent) are deemed as the top indicators of a risk-based culture within insurance firms.
- Just over 11 percent of survey participants ventured that their boards are currently using the output from the internal capital model in business decisions. The use of risk-based return on capital measures in business planning is a little 'healthier' with around a quarter of boards sampled adopting such metrics.

Just over one in four (26 percent) also reveal that their board has only sometimes been involved in actually running their firm's ORSA (Own Risk and Solvency Assessment) process.

- A reflection that insurers are currently very much in project mode is that nearly 78 percent of the survey respondents perceive their boards to own the Solvency II projects in their respective firms.

The next section of this report explores each of these findings in more detail. It is followed by a section that outlines some of the key implications for insurers as they grapple with the challenges posed by nurturing an enabling risk culture within their organisations.

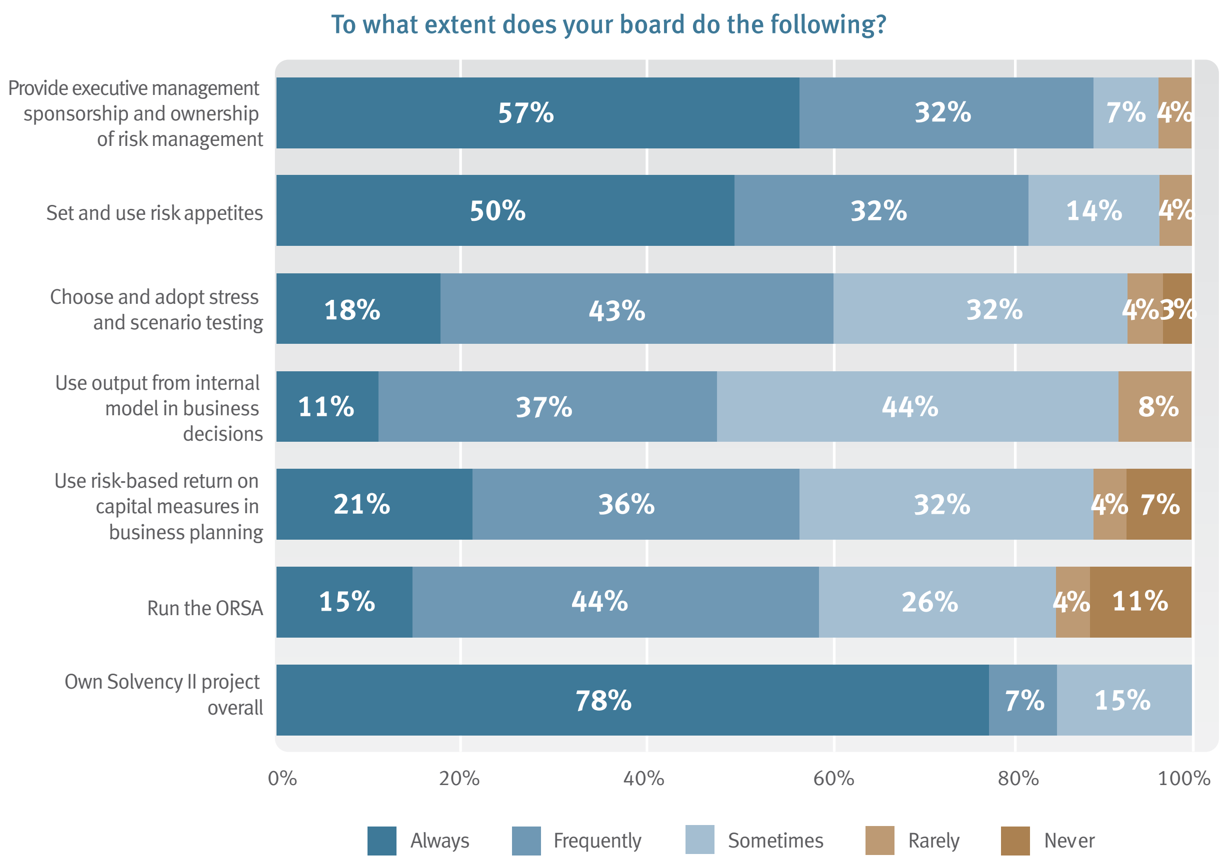
DETAILED SURVEY FINDINGS AND ANALYSIS

Board involvement

Survey respondents were asked the extent – ranging from always, to frequently, to sometimes, to rarely, to never – to which their respective boards get involved in specific areas of business activity. While an overriding 78 percent of respondents retain that their boards own the overall Solvency II project within their organisations, the responses also reveal that 44 percent of boards only sometimes use the output from the internal model in business decisions. This finding could well reflect the fact that internal capital model development is still not at the prerequisite level of maturity to enable its output to be used in business decisions.

Higher on the risk management maturity curve, however, are the responses that 57 percent of boards are always deemed to provide executive management sponsorship and ownership of risk management, while 50 percent of boards have been said always to set and use the organisation's risk appetite. Another business activity that is still in a maturing stage is the ORSA (Own Risk and Solvency Assessment) – 44 percent of the boards of those surveyed are frequently involved in running the ORSA, and 26 percent are involved only sometimes. There is also some room for progress in terms of the use of risk-based return on capital measures in business planning. The proportion of boards that use risk-based return on capital measures (32 percent) is not far behind the proportion of boards that frequently use such metrics (36 percent), indicating that generally boards are moving in this direction.

Table 1: Board involvement in business activity areas



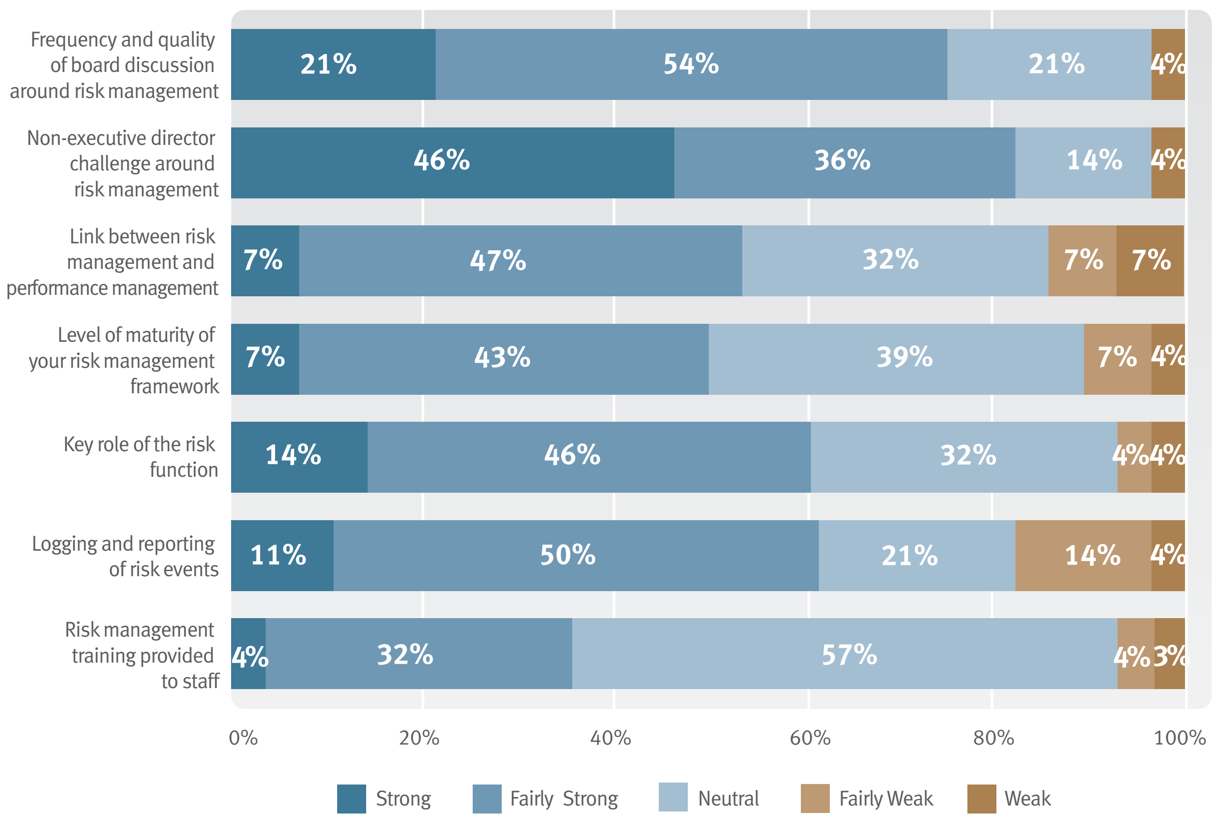
Strength of risk culture

The strongest risk culture indicator reported by respondents (46 percent) is non-executive director challenge of risk management. Equally, the frequency and quality of board discussion of risk management are deemed to be fairly strong by 54 percent of those surveyed. A little over 14 percent of respondents describe the link between risk management and performance management as between fairly weak to weak, which is an indicator of the lack of risk management embeddedness in those organisations. More than half of the respondents (57 percent) indicated that they perceive the risk management training provided to staff in their organisation to be neither weak nor strong. We consider this response to be symptomatic of a certain agnosticism as to how widespread, across business functions, risk management training ought to be in an organisation.

When describing the level of maturity of their risk management framework, 43 percent of survey respondents defined it as fairly strong and 39 percent opted for a neither weak nor strong tag to describe the risk management framework within their organisation. This corroborates the earlier findings that board involvement in a number of business activities – such as the choice and adoption of stress and scenario testing and the running of the ORSA – is correlated to the development maturity of the underlying risk management framework. Half of all respondents report that logging and reporting of risk events is fairly strong in their organisation and 46 percent of respondents attribute the strength of their risk culture to the key role of their risk function.

Table 2: Strength of risk culture indicators

How would you rank the strength of these risk culture indicators in your organisation?

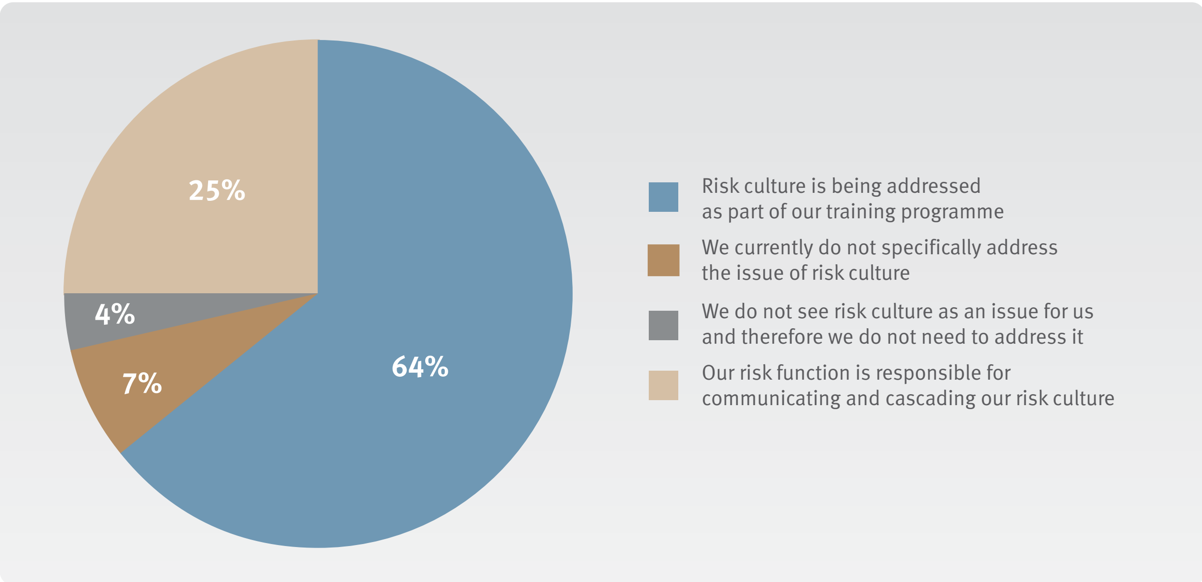


Addressing risk culture

In an endeavour to explore whether the UK insurance industry perceives risk culture to be an issue and, if so, to determine their preferred approach to tackling it, respondents were asked how their firm is addressing the issue of risk culture. The majority of respondents – 64 percent – said that, in their organisation, the issue of risk culture is being addressed as part of their training programme. It is debatable, however, whether training would have the desired impact in driving the required culture change. A relatively significant proportion of respondents – 25 percent – attributed the responsibility for communicating and cascading risk culture to their risk function, hence missing the opportunity to set the tone from the top. While still recognising that risk culture is an issue within their own firms, 7 percent of survey respondents revealed that currently they are not specifically addressing the issue of risk culture by adopting any particular approach. Interestingly, just 4 percent of respondents do not perceive risk culture to be an issue whatsoever for their organisation and, consequently, conclude that there is no explicit need to address it in any way within their firm.

Table 3: Risk culture addressed as part of training programme

How is your firm addressing the issue of risk culture?

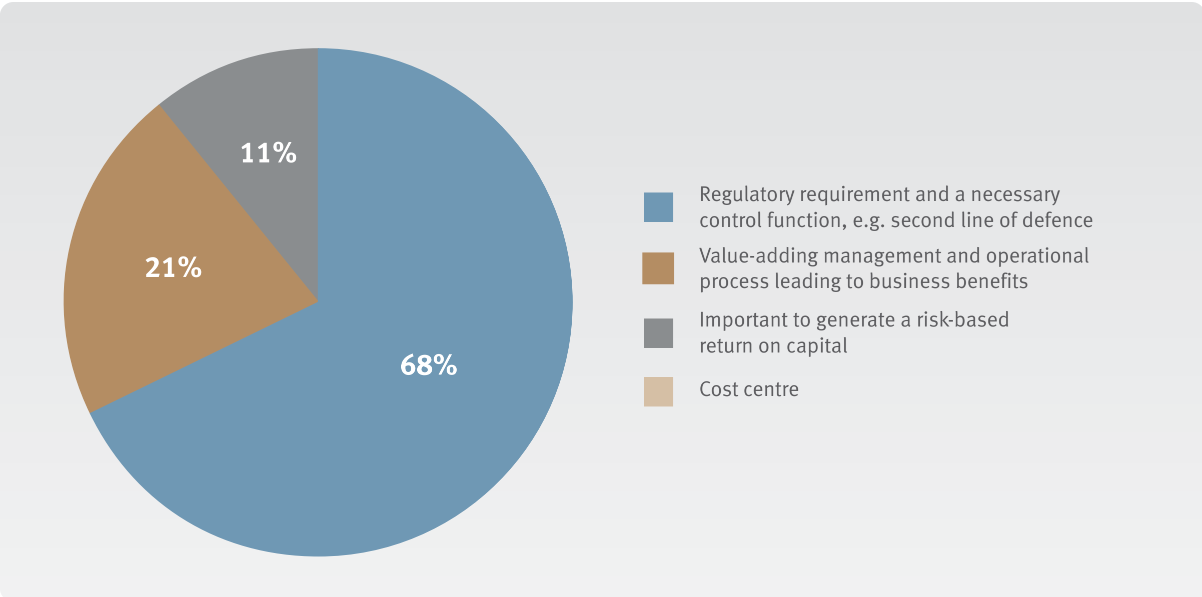


Perception of risk function

At a time when the UK, indeed the EU-wide, insurance industry is grappling with a wholesale regulatory overhaul that is Solvency II, it is perhaps unsurprising that over two-thirds of survey respondents believe that, in their organisation, the risk function is perceived as a regulatory requirement and a necessary control mechanism. This harkens back to the argument outlined previously about the current level of maturity of risk management frameworks within the insurance industry. It appears that at this, albeit advanced, development stage of risk management practices, UK insurers are still not in a position to reap rewards from their major investments in building their risk management frameworks to the high standard exacted by Solvency II requirements. While none of the respondents ventures so far as to say that their risk function is perceived as a cost centre, only 11 percent of those surveyed actually deem their risk function important to generate a risk-based return on capital. Encouragingly, 21 percent of respondents do conclude that their risk function is a value-adding management and operational process that leads to business benefits.

Table 4: Risk function as a regulatory requirement and a necessary control mechanism

How do you think the risk function is perceived in your organisation?

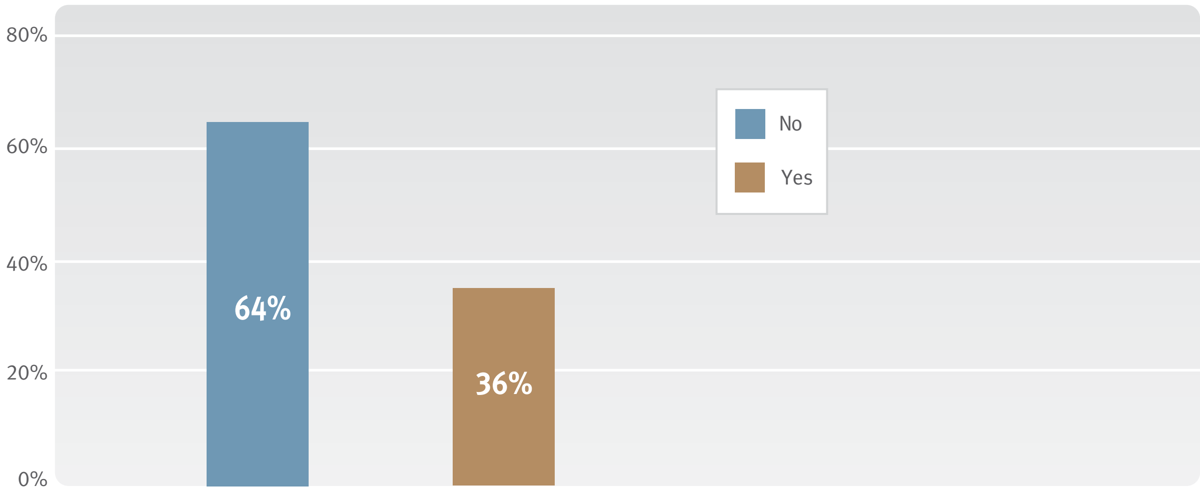


Strategic risk management vs. risk management processes

Given the survey findings discussed thus far, it is unsurprising that 64 percent of the survey participants revealed that their CRO or head of risk does not yet sit on the main board. This finding highlights that the focus within the UK insurance industry appears still to be on risk management as a process rather than as a strategic tool. This might also explain the relatively lower level of board involvement in such business activities as running the ORSA and using risk-based return on capital metrics in their business planning. One could argue that once risk management processes have bedded down into the day-to-day running of the business, the next wave of development, up the risk management maturity scale, will be towards a more strategic rather than operational orientation. This improvement would then enable the fusion of business strategy, risk management and capital planning as a main driver of organisational growth.

Table 5: CRO not yet on the main board

Does your CRO or head of risk sit on the main board?



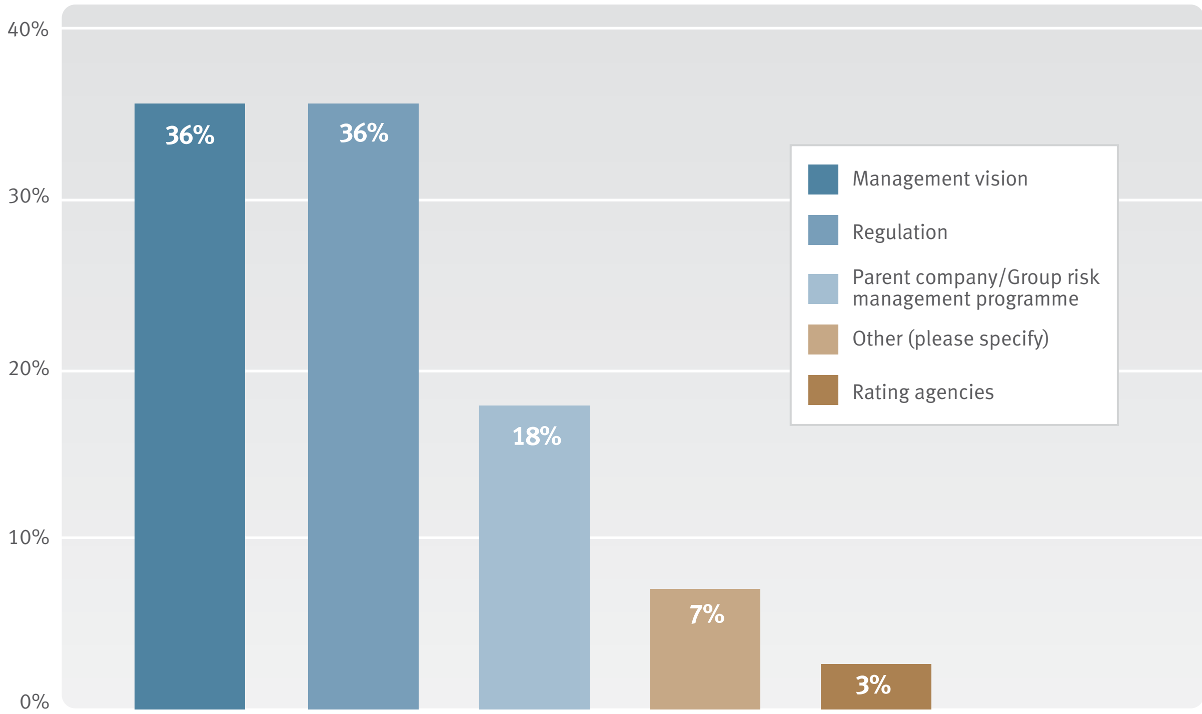
Drivers of risk management practices

Echoing the findings outlined previously, one-third of respondents have ticked regulation as the primary driver that has spurred the development of risk management practices within their respective organisations. This response perhaps reflects a rather pervasive regulatory mindset within the UK insurance industry and further helps to explain why more than two-thirds of respondents simply think of their risk function as a regulatory requirement. As a further attestation of this, some respondents also commented that risk management improvement in their respective firms was the direct outcome of the RMP (Risk Management Plan) resulting from an FSA Arrow visit.

Nearly one in five respondents – 18 percent – have recognised that parent company or group risk management programmes have also been influential in directing and driving the risk management efforts by their entity within the overall group. Only 3 percent of respondents have described rating agencies as the primary driver prodding the development of their risk management practices.

Table 6: Main drivers of risk management practices

What has primarily driven your risk management practices up until now?

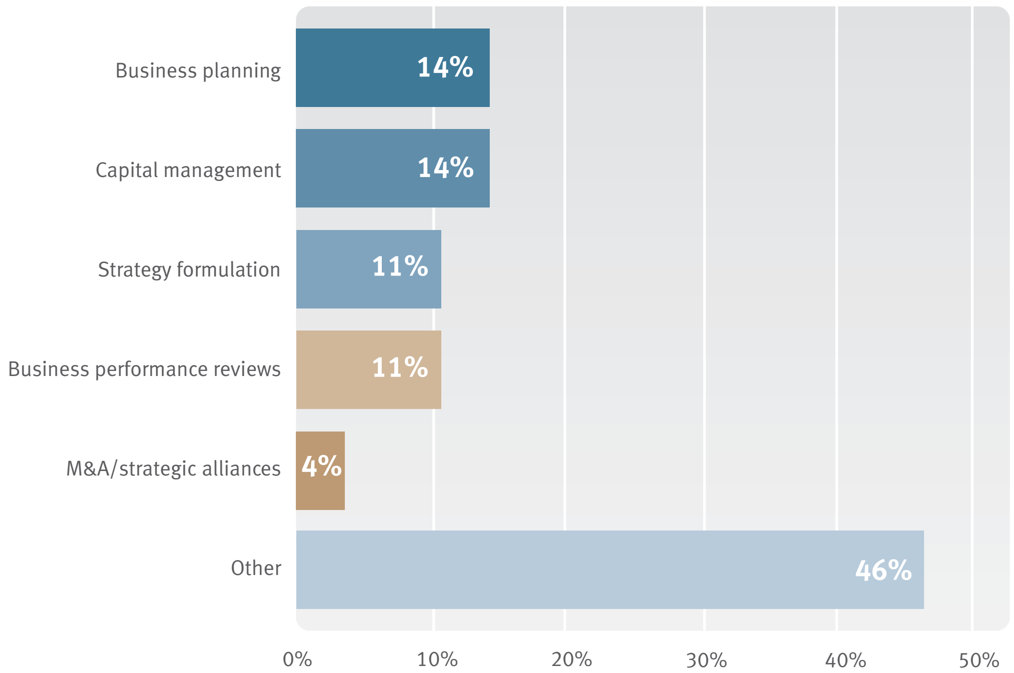


Business activities the risk function typically gets involved in

When asked which business activities their risk function typically gets involved in, 46 percent of survey respondents chose the 'Other' category as their response and qualified that with a commentary that, outside of business performance reviews, their risk function is involved in a combination of strategy formulation, business planning and capital management. While just 4 percent of respondents outlined that their risk function gets involved in any M&A activity within their organisation, none of the respondents highlighted that their risk function is involved in entity domiciliation and outsourcing decisions.

Table 7: Risk function involvement

Which business activities does your risk function get involved in?

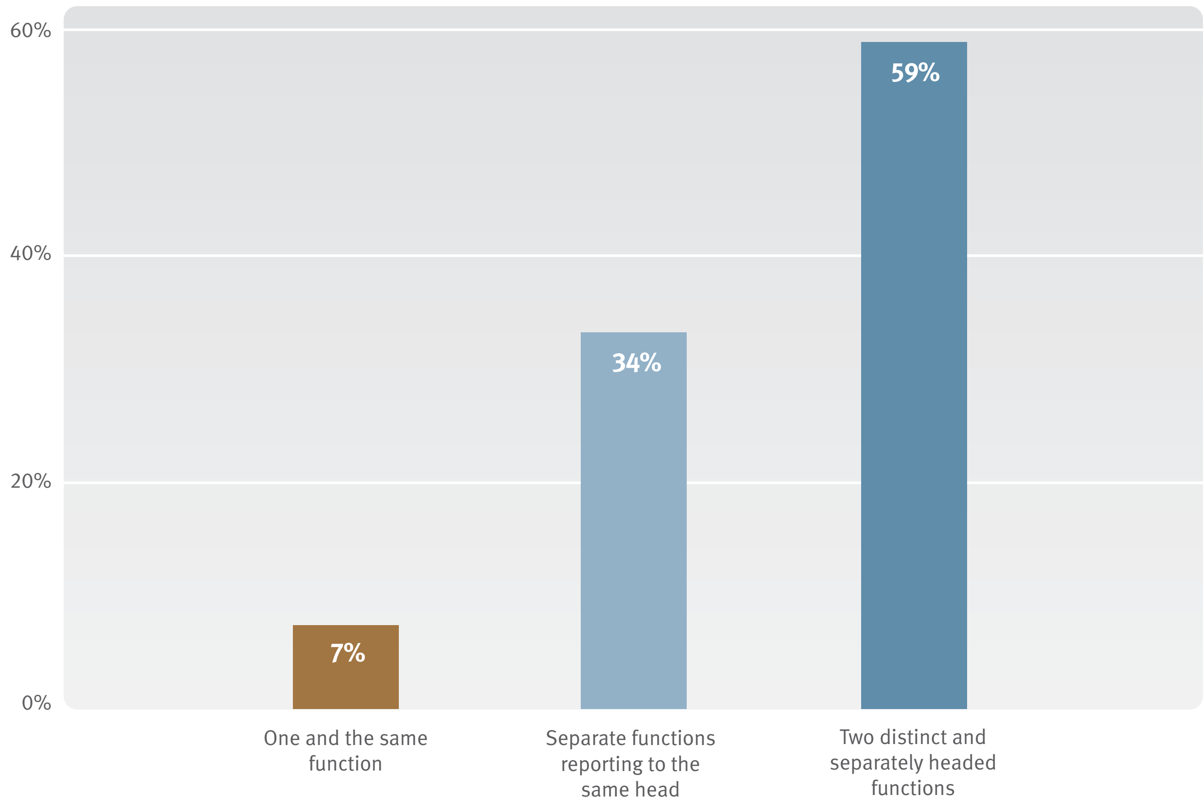


The relationship between risk and compliance

In an attempt to gauge the degree of blurring between risk and compliance functions, participants in the survey were asked to gauge the overlap of responsibilities between their risk and compliance departments. The majority of respondents (59 percent) confirmed that their risk and compliance functions are two distinct and separately headed functions. One-third of the respondents stated that, while risk and compliance are separate functions, both report to the same head. Only 7 percent of survey respondents revealed that their risk and compliance functions are in fact one and the same.

Table 8: Overlap between risk and compliance functions

Your Risk and Compliance functions are:

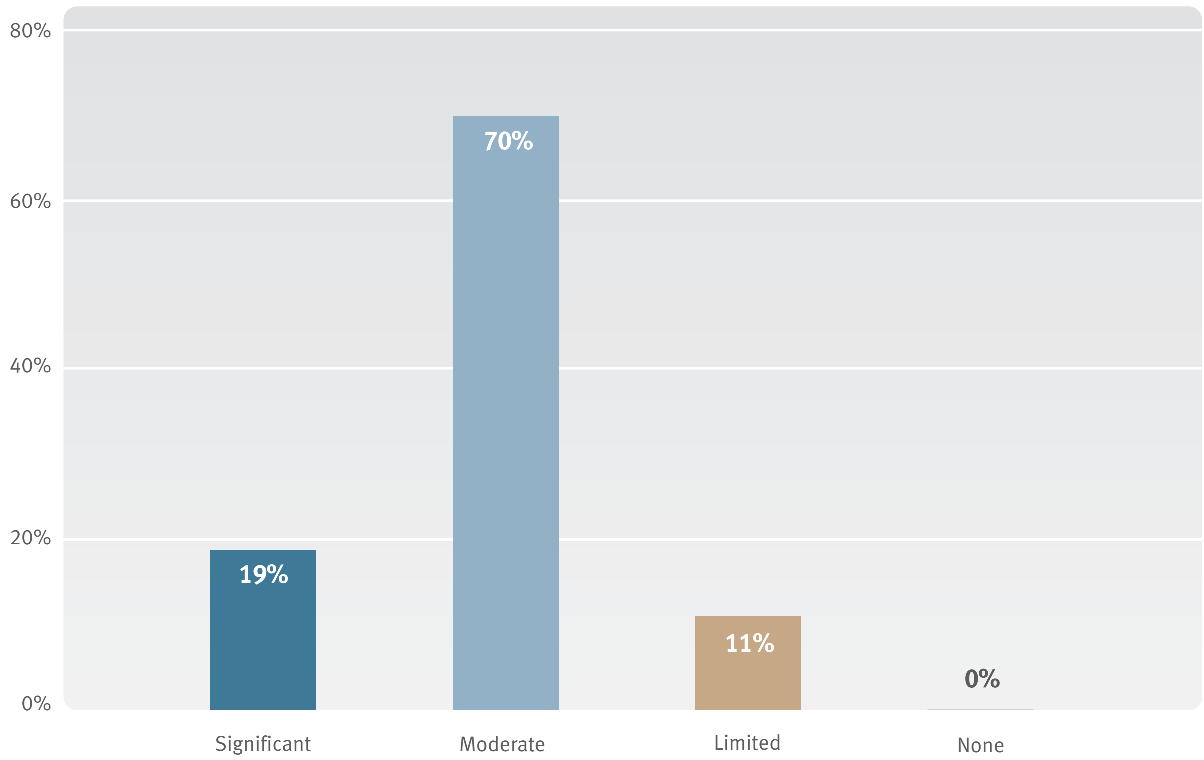


Impact of internal audit on risk management improvement in the organisation

Further exploring cross-functional dynamics, survey participants were asked to evaluate the impact their internal audit function – or third line of defence – has had on the improvement of their risk management framework and practices – the second line of defence. Seventy percent of respondents retain that their internal audit function has had a moderate impact on risk management enhancement within their respective organisations. At the opposite ends of the spectrum, 19 percent of respondents feel that their internal audit function has had a significant impact on risk management, while 11 percent of respondents report that in their case this impact has been limited.

Table 9: Moderate impact by internal audit on risk management improvement

What impact do you feel your internal audit function (third line of defence) has on risk management improvement in your organisation?

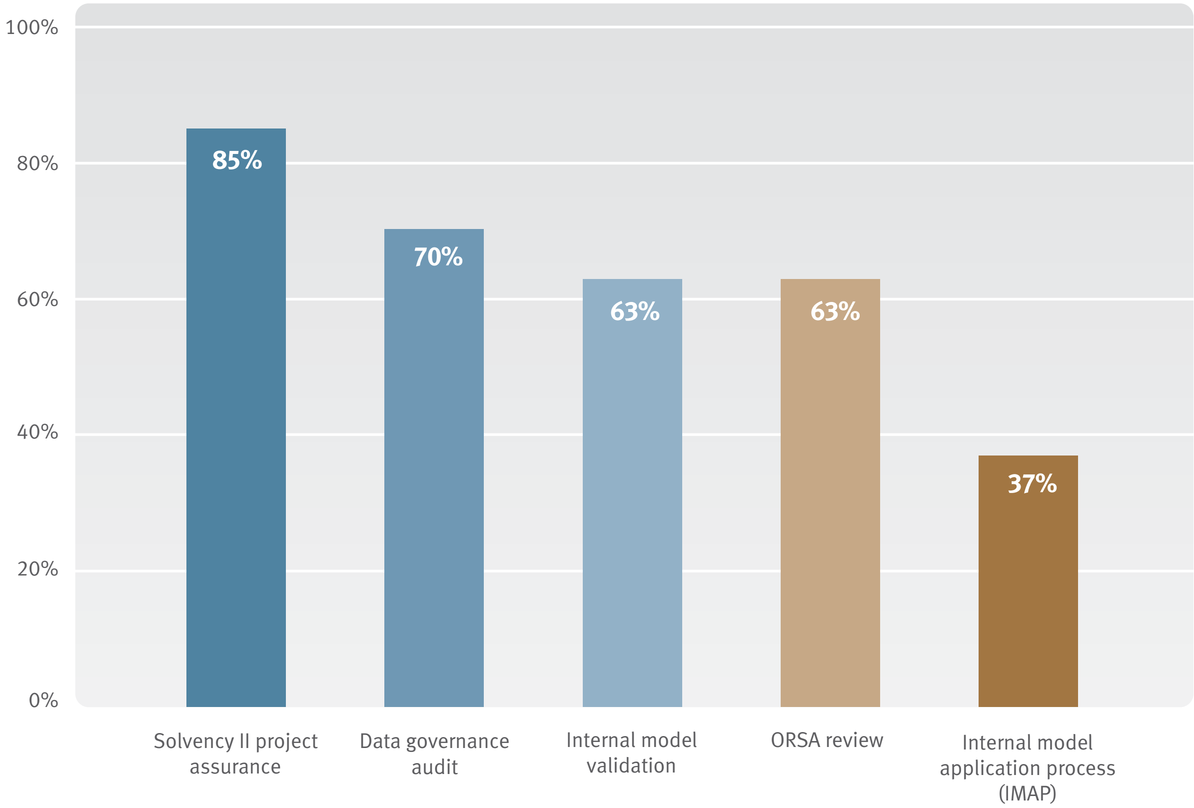


Activities in which the internal audit function typically gets involved

Reflecting the fact that the internal audit function is increasingly playing more of a lead role in Solvency II implementation, 85 percent of respondents confirmed that their internal audit function provides Solvency II project assurance. Additionally, 63 percent of respondents included internal model validation and ORSA review on the list of activities in which their internal audit department is typically involved. In line with expectations, data governance audit is another activity on the internal audit function priority list, with 70 percent of respondents verifying this.

Table 10: Internal audit function involvement

In which of these activities does your internal audit function get involved?

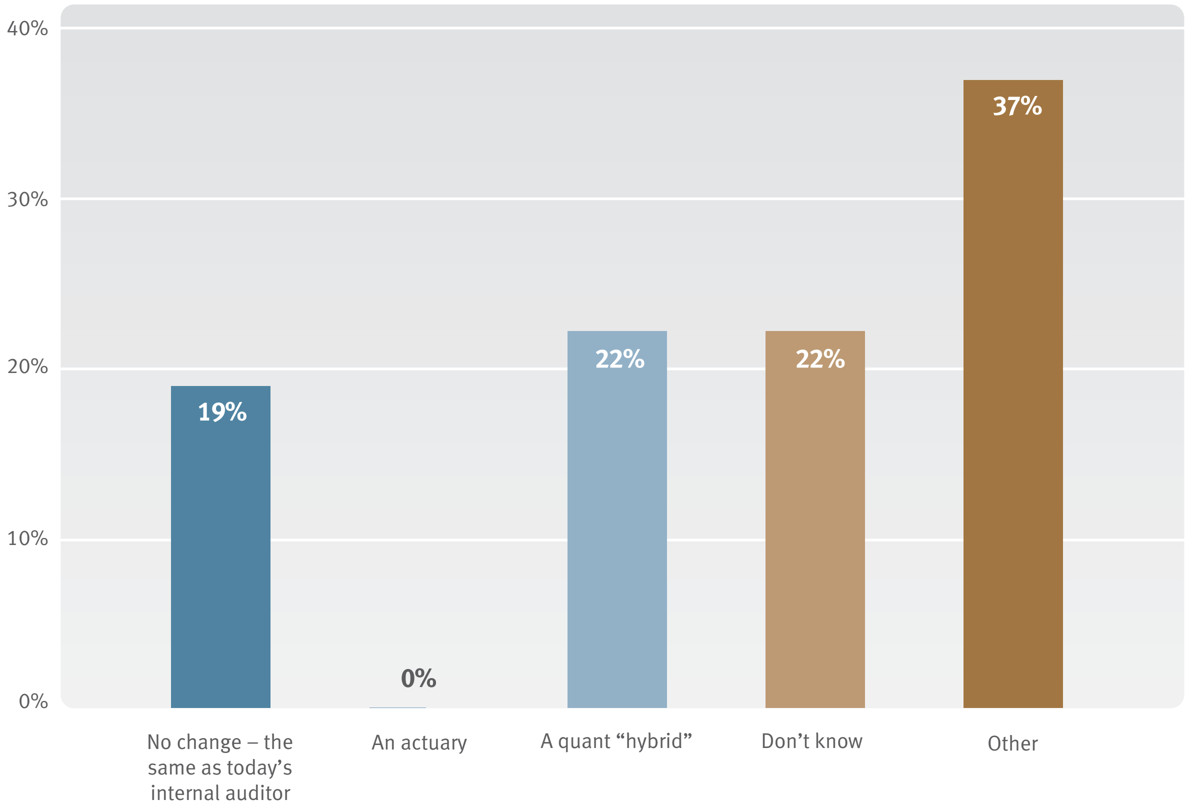


The internal auditor of the future

More than a third of the survey participants – 37 percent – opted for the 'Other' category in their response to this question which probes how respondents envisage today's internal auditor would need to change in the future. Within the 37 percent, respondents explained that they see the internal audit function increasingly evolving into a team, mostly on a co-sourced arrangement basis, that holds a multi-disciplinary skill set. Underscoring the notion of a risk culture that is pervasive organisation-wide, these respondents also emphasised that internal auditors need to be more risk management aware, as well as proactively au fait with the relevant regulations and regulatory developments affecting the business. It appears that there is no doubt that in the future an internal auditor needs to be quantitatively skilled if not quite a qualified actuary.

Table 11: Expected future changes in internal audit

How do you envisage today's internal auditor needing to change for the future?



IMPLICATIONS FOR INSURERS

Optimum business benefits depend on an effective and enabling alignment between risk culture and an insurer's risk management framework and risk management practices.

A board-endorsed risk culture embedded organisation-wide requires a conscious willingness from senior management within the insurance industry to blend together the 'right' amount and quality of leadership, strategy, training and rewards.

Following are some of the key questions insurers should be asking themselves in their endeavour to nurture within their organisation a deeply rooted risk culture:

Leadership

- Is there a common 'risk' language and definition across the organisation?
- Do people talk openly about risk management and is risk management embedded in the vocabulary of the organisation?
- Is the tone set at the top compatible with an enabling risk culture?

Strategy

- Is risk strategy incorporated in and aligned with the organisation's overall business strategy and growth objectives?
- Is there a clear understanding and articulation of why effective risk management is a key business process that adds real value and generates business benefits?

Training

- Does the organisation formally review the effectiveness of its risk management framework and practices so as to learn from this evaluation and then improve its approach to risk management?
- Does the organisation's variety of training programmes encompass risk management and to what extent?

Rewards

- Is the organisation environment one where individuals feel comfortable in challenging other people irrespective of their status or authority and is constructive challenge encouraged as part of everyone's expectations?
- Are the individual interests of employees across the organisation aligned with those of the overall organisation, including its risk strategy, appetite, tolerance and risk management approach?

SUMMARY – A CALL FOR ACTION

The survey results show that despite the fact that the insurance industry recognises that it must embed a positive risk culture to reap the full benefit of Solvency II, this is not quite yet happening in practice. While most boards set risk appetite, take ownership of Solvency II, sponsor risk management and measure risk – in other words, tick all the right boxes – the survey finds that the risk function does not play a significant role in formulating strategy or business planning.

Moving away from a tick-box exercise so as to better align risk culture with the risk management framework and risk management practices within an organisation necessitates a call to action for insurers:

1. For a board-endorsed risk culture to take root and permeate organisation-wide, greater presence of CROs and heads of risk is necessary on insurers' main boards. In addition, risk management improvement needs to be driven primarily by management vision and not by the regulatory 'stick'.
2. To reap due rewards from the investment over the past few years in risk management, a change in the mindset of how the risk function is perceived within the organisation is fundamental. The risk function is not a cost-centre or a mere regulatory requirement. It is a value-adding management process leading to business benefits and important for generating a risk-based return on capital.
3. Consequently, the risk function within the insurance industry must rise to the occasion so as to step up its involvement in risk-critical business activities such as strategy formulation, business planning and capital management.

METHODOLOGY AND DEMOGRAPHICS

Over March and April 2012, Protiviti conducted a survey around the challenges of aligning risk culture with risk management framework and practices among UK insurers. The study was conducted via an online survey as well as through one-to-one interviews. Respondents were mostly C-level across these roles: CROs, heads of risk, chief actuaries, chief financial officers (CFOs), heads of internal audit, heads of compliance, as well as non-executive directors. Specifically, the survey focused on exploring among UK insurers that operate multinationally: the significance of an enabling risk culture; the extent of board involvement in risk-critical business activities; and the 'blur' of responsibilities across a number of risk-relevant functions.

Since completion of the survey was voluntary, there is some potential for bias if those choosing to respond have significantly different views on matters covered by the survey than those who did not respond. Therefore, our study's results may be limited to the extent that such a possibility exists. Despite this limitation, we believe the results herein provide valuable insights regarding UK insurers' current thinking around risk culture.

Thirty respondents participated in the study. Following are details regarding the respondents.[1]

Respondents (type of institution)

Composite insurer	12%
Life insurer	12%
Non-life insurer: Multiline	58%
Non-life insurer: Monoline	8%
Bancassurer	4%
Broker	4%
Did not respond	2%

Respondents (department)

Risk	31%
Actuarial	12%
Finance	12%
Internal Audit	19%
Operations	4%
Board	4%
Executive Management	4%
Non-executive Management	4%
Did not respond	10%

[1] All demographic information was provided voluntarily by respondents.

ABOUT PROTIVITI

Protiviti (**www.protiviti.com**) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit. Through our network of more than 70 offices in over 20 countries, we have served more than 35 percent of FORTUNE® 1000 and Global 500 companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

In addition, we have worked with more than 30 percent of the FTSE 100 from our London office.

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Financial services organisations face a dynamic regulatory landscape that will define the ways they innovate, manage risk and succeed over the next decade.

Global organisations have the added complexity of working across regulatory differences between countries. In these uncertain times, organisations with strong risk management and an enterprisewide view of compliance will have an advantage because they will be better able to adapt to and manage changing regulations, causing less disruption to their business operations. Success in this area requires good information and effective risk models for your business and the market. Our risk and compliance professionals have worked with financial services clients around the world. We can help you evaluate and improve your existing risk management efforts. Our professionals create regulatory compliance solutions that align with your business strategy and risk profile. Our multidisciplinary team can ensure your technology infrastructure is supporting your objectives. We also can implement software and controls to improve performance and efficiency.

We help financial services organisations in the following areas:

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