Solvency II, scheduled for implementation in 2013, introduces sweeping regulatory reform for insurance companies. One of the underlying objectives for Solvency II is to improve the system of governance within an organisation. However thus far, many insurance companies have been focusing on improving risk measurement, rather than taking the opportunity to implement real cultural change. To do this effectively, companies need to be aware of the current risk culture within the organisation. In this document we set out our solution to enable companies to make a quick start on measuring and improving risk culture and associated risk management, and discuss our experience of doing this in practice.

The changing face of risk culture

Risk culture can be defined as the norms and traditions of behaviour of individuals and of groups within an organisation that determine the way in which they identify, understand, discuss and act on the risks the organisation confronts and takes. Risk culture is the responsibility of the leadership team. It is clear that a poor risk culture in certain organisations helped contribute to the last financial crisis. It is therefore no surprise that regulators and rating agencies see this as one of the areas of focus in order to understand whether risk is handled appropriately in an organisation.

Broader regulatory reform such as Solvency II expects risk management to be embedded in the day-to-day activities of companies. In addition to external pressure, there may also be internal motivations for improving the measurement and embedding of risk management in an organisation. Towers Watson’s recent Enterprise Risk Management (ERM) survey indicated that embedding ERM is proving to be a significant challenge.

In particular, almost three quarters of respondents indicated that risk culture had a significant impact on business performance during the financial crisis, with around 40 of these respondents saying that their current risk culture actually hindered their business performance.

It is evident that companies are beginning to understand that a robust risk culture which emphasises the role of risk as the common thread running through decision making in firms at all levels can lead to competitive advantage.

“Broader regulatory reform such as Solvency II expects risk management to be embedded in the day to day activities of companies.”

Some companies have already made steps in strengthening the risk culture within the organisation, for example in the formation of risk committees, strengthening the role of the CRO and adjusting senior management incentive plans to have a greater element of risk focus. However, more can be done.
How can risk culture be measured?

Some central elements that would be expected from an effective risk culture within an organisation include committed leadership, an effective governance structure with clear responsibilities and timely escalation procedures, continuous and constructive challenges, active learning from mistakes and incentives that reward thinking about the risk management objectives of the whole organisation.

We see the challenge of measuring risk culture as no different from measuring other organisational aspects and we have therefore approached it as such. We have combined our experience in advising the insurance sector on risk management with our market-leading organisational research offering. Drawing upon this unique set of capabilities, we have designed a risk culture diagnostic tool consisting of a set of survey questions that have been specifically developed to measure key aspects of risk culture in a financial services context.

The Towers Watson risk culture diagnostic tool

Our underlying premise is that the best method to understand the risk culture within the organisation is to engage directly with those employees who are involved and to capture free and frank views via the use of our online survey.

The survey consists of a combination of standard questions supplemented with bespoke questions and open-ended questions to gather further insights on how risk management really functions within the company. The standard questions can be benchmarked against a relevant peer group to give management a view of progress against peers.

Once the questions have been agreed the survey can be repeated on a regular basis using these same questions to allow the company to compare results over time, measuring progress and evaluating actions taken.

“Our underlying premise is that the best method to understand the risk culture within the organisation is to engage directly with those employees who are involved and to capture free and frank views via the use of our online survey.”

Typically, we would categorise the questions into different areas as shown in Figure 01. The categorisation is flexible and can be tailored to match a firm’s organisation structure so that there is a clear owner for each of the individual areas.

“Underpinning the effectiveness of the entire risk management processes is the company’s risk management culture. Risk management culture is the degree to which risk and risk management are important considerations in all aspects of corporate decision making.”


“Unacceptable culture within firms was a major contributor to the financial crisis and so regulators should play a greater role in judging how culture drives firms’ behaviours and impacts on society as a whole...The end goal should be that firms understand their own culture and the potential risks posed by the wrong culture.”

Hector Sants, UK Financial Services Authority June 2010

“That risk management system shall be effective and well integrated into the organisational structure and in the decision-making processes of the insurance or reinsurance undertaking with proper consideration of the persons who effectively run the undertaking or have other key functions.”

Article 44 (1) Solvency II Directive

“The matching of the own funds to the risk profile should help promote a strong culture of risk management, which in turn is a key underlying feature of the ORSA process and, more widely, in soundly running the business.”

CEIOPS ORSA Issues Paper May 2008

“Risk comes from not knowing what you’re doing.”

Warren Buffett
Once the questionnaire is tailored and finalised, Towers Watson will launch it to an identified group of employees – typically those whose roles involve aspects of business risk. These include specialist functional roles, such as compliance, risk management, finance and strategy, but can include sales and customer service roles too.

This survey provides a rich source of data which can then be analysed and benchmarked both over time and across other similar organisations. This would include an interpretative summary for the leadership within the organisation, highlighting key results, implications and recommendations as well as more granular findings by business unit or function to highlight areas for improvement.

### Figure 01. Typical coverage of the risk culture questionnaire

<table>
<thead>
<tr>
<th>Category</th>
<th>Coverage</th>
<th>Potential owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organisational culture</td>
<td>The values and norms of behaviour within the organisation generally support effective management of risk</td>
<td>Board/executive</td>
</tr>
<tr>
<td>Risk, appetite, strategy and policies</td>
<td>The company’s attitude towards risk is clear and appropriate</td>
<td>Board/executive</td>
</tr>
<tr>
<td>Leadership commitment</td>
<td>Leadership throughout the organisation has a focus on risk appropriate decision making, communication and behaviour</td>
<td>Executive</td>
</tr>
<tr>
<td>Roles and organisational structure</td>
<td>Roles, responsibilities and rewards are determined in keeping with effective risk management</td>
<td>Executive/HR director</td>
</tr>
<tr>
<td>Process and controls</td>
<td>Risk controls and process are appropriate, clear, timely and effective</td>
<td>Risk management function/internal audit</td>
</tr>
<tr>
<td>Reporting and management information</td>
<td>There is effective reporting and documentation of risk activity</td>
<td>Finance/risk management function</td>
</tr>
<tr>
<td>Technology and infrastructure</td>
<td>IT systems are designed in a way that supports effective risk management</td>
<td>Chief information officer</td>
</tr>
<tr>
<td>Tools and methodology</td>
<td>The approaches to manage risk are clearly understood and appropriate to the need</td>
<td>Finance/risk management function</td>
</tr>
</tbody>
</table>

### Figure 02. Survey outputs inform internally and externally

- **External**
  - Regulators
  - Ratings agencies
  - Markets

- **Internal**
  - Dialogue
  - Local engagement
  - Local improvements
Putting it into practice – case study

Context

Our client is a long-standing mid-sized financial services company with businesses in both insurance and banking. In 2008/09 the company was hit hard by the financial crisis, in keeping with the rest of the sector.

The company made a new senior appointment to introduce improved approaches to risk management and oversee risk across the group.

Working closely with the HR director, it became clear that risk culture was viewed as a critical aspect in managing risks effectively. It would be vitally important to have clear insights into the attitudes, beliefs, understanding and behaviours of people throughout the organisation.

Approach

Towers Watson was appointed to design and implement the company’s first risk culture survey. The objectives were to measure people’s attitudes to risk management, their reaction to changes put in place so far, identify areas where further progress was needed, benchmark the findings externally and set a baseline against which to measure progress.

The initial phase of the project was one of clearly scoping the objectives and consulting with internal stakeholders about the survey methodology and questionnaire content, through a series of interviews and focus groups. Towers Watson’s extensive database of questions and our measures of risk culture provided a starting point but, like any organisation, our client’s context and needs were unique, requiring a bespoke questionnaire and approach.

It was decided that the population ‘in-scope’ for the survey would include all those people who had a significant aspect of managing risks in their role. This included all senior managers and people in functions such as risk, finance and strategy. It also included people in sales/service managerial roles across both major businesses – for example branch managers across the retail bank network and customer service team leaders in the insurance business. Indeed, these were the key players whose views and behaviour were hardest to gauge without the use of a survey.

Introducing such an approach required a good degree of support communication, informing business leaders of the role and purpose of the survey and reassuring employees that although the survey was sponsored by the company, their personal confidentiality was assured through the use of a reputable third party. After the survey went live, participation rates were tracked across the business to ensure a good representative response, and additional communications put in place where needed.

Analysis and key findings

The survey has proved extremely helpful in evaluating the success of changes made to date, allowing the client to celebrate progress while identifying areas where further improvement could be targeted.

The clear data and graphics have proved powerful tools for communicating the topic of risk culture both internally and externally. The external benchmarks provided the necessary context in which to interpret findings in a realistic way.

As shown in Figure 03 some of the findings include:

- There was a clear message that employees valued integrity and acted accordingly, and felt that the company was ahead of competitors in its approach to risk management and treatment of customers.
- Compared to external benchmarks, more people felt that the changes in risk management had been well designed, well led and well implemented. This has given leadership confidence in the initial work that has been done.
- Communication of the changes was found to be more effective in some parts of the business than others, and more ‘top down’ than ‘bottom up’. While people felt able and confident to report any concerns through the appropriate channels, few felt that they had the opportunity to discuss risk policies and procedures with colleagues in the risk function, and consequently felt a lack of personal commitment and ‘ownership’ of them.
- There was a consensus that risk management was a shared responsibility across all employees but many people still felt that the primary responsibility for risk management rested with the risk/compliance function, rather than with the business. There were similar indications about the perceived ‘value’ of risk management, with many people regarding risk management procedures as a burden rather than value-adding.
- The survey also identified some positive aspects of performance management and reward in relation to risk management, while again highlighting some areas where more progress was needed. For example, risk-related controls and penalties had been successfully implemented, but few people felt that there was appropriate positive recognition and reward for taking appropriate risks and managing risk effectively.
Insights | January 2011

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Figure 03. Sample findings

People feel that it is safe to speak up, although fewer feel that the climate promotes challenge to tradition

Most of the time it is safe to speak up in this company

<table>
<thead>
<tr>
<th>Total favourable</th>
<th>Differences from benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client result overall</td>
<td>Towers Watson national norm</td>
</tr>
<tr>
<td>Towers Watson global financial services companies norm</td>
<td></td>
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</tbody>
</table>

There is a high level of confidence in the design of recent changes

Management provides a clear sense of direction in relation to risk management

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<td></td>
</tr>
</tbody>
</table>

Over the past year or so, changes in the way we manage our risk have been well designed

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There is a variety of views as to who is responsible for risk management

Overall, the survey was an essential tool in our client’s approach to risk management. As expected, there were varying perceptions from different parts of the business, so cutting the data by business, job level and function proved invaluable in identifying localised issues.

In addition, verbatim ‘comments’ from the survey provided a rich source of suggestions and personal perspectives to guide subsequent changes – whose impact can be evaluated by measuring future survey results against this initial baseline.
Benefits from performing a risk culture diagnostic

There are a number of key business benefits to be gained from performing the risk culture diagnostic.

Setting the tone from the top

The tone on risk culture is set at the top of an organisation. If the leadership of the organisation makes this a priority then this will filter through the organisation. Our diagnostic is a cost-efficient way of engaging throughout the organisation on risk culture by soliciting views from employees while putting out the message that management believes this is a priority. Communication of results of the diagnostic can send an unambiguous statement that risk culture is on the leadership agenda and lack of awareness, indifference or disregard for risk is not acceptable.

People are highly sensitive to signals arising from how an organisation reacts to bad behaviour. If bad behaviour (ignoring limits, failure to complete risk reports or disregard for processes) is not identified, monitored and corrected then the firm risks perpetuating a cavalier attitude to risk and control throughout the organisation. On a similar note, companies could use the survey to help identify and reward good behaviour.

Engaging external stakeholders

Solvency II places strong emphasis on embedding risk management in the organisation. The risk culture diagnostic provides comprehensive empirical evidence which can be shared with the regulator in order to help satisfy the ‘Use Test’. We would recommend carrying out the first survey now and repeating the survey on an annual basis. This should show a track record of improvement as the organisation iteratively improves the deficiencies identified.

Risk culture goes beyond the regulators. In the current economic environment, companies are looking for opportunities to differentiate themselves from their peers particularly in the area of risk management. The risk diagnostic provides credible evidence which can be used to inform rating agencies and other stakeholders. Looking forward to the future, one can envisage an environment where reporting and monitoring risk culture becomes a key part of public disclosures.

Creating an internal dialogue

Carrying out a survey to specifically measure risk culture allows the organisation to promote a common language and structure in which to discuss risk culture and risk management across the organisation. Many organisations currently lack this focus and consistency.

In some cases, it has been difficult to engage with the Board on risk management as the focus is often on the technical details around risk measurement. However, the results of the diagnostic are visual and easily communicated and hence engaging. In addition, the benchmarking provides context of the results in relation to similar organisations and the graphical analysis is worth the proverbial 1,000 words.

Better informed business decisions

The diagnostic tool is effectively a high-level gap analysis for the organisation. Results can be analysed at various levels (depending on data capture) and can be used to identify hot spots for remedial activity whether this be by business unit or function. Our user-friendly reporting tools engage managers in understanding risk culture in their own part of the business, and encourage constructive dialogue on improvement. However, for this to hold, employees must feel secure to answer truthfully and this is best achieved by using a specialist provider.

As a result of Solvency II, many companies are intending to spend significant amounts of money to improve their risk measurement via internal models, overhaul their system of governance and invest in staff training to become more risk aware. The diagnostic tool allows one to monitor development of staff over time to understand the value from the investment in training. It provides a mechanism for measuring progress against specified ambition targets and a quantitative estimate on the return on investment from training in risk management.

Creating real change

Once a survey has been completed, it is important to address those areas where a need for change has been identified. There are a number of ways in which a risk culture can be improved. For example:

- **Encouraging behaviour through incentives:** Linking employees and executives compensation and incentives to suitable risk-based performance metrics is an effective way to encourage the appropriate management of risk within an organisation.
- **Improved processes and information:** In some cases, absence of a risk culture can be due to a lack of appropriate information available to management. Processes can be improved to make it easier to record risk events and produce appropriate risk metrics. Systems can be adapted to extract relevant information on which management can base effective risk management decisions.
- **Change management:** Where there have been recent changes to the aims of the risk culture, it may be that individuals have not yet bought in to these changes. In this case, change management techniques such as education and training can be used to improve employee engagement with the new risk culture.
The last word

Relying on processes and formalised controls will not be enough to give the confidence that an organisation is capable of state of the art risk management. There will always be ways to circumvent the models, systems and controls. It is therefore necessary for the leadership team to encourage a strong risk culture where employees are risk aware, understand the consequences of their decisions and are confident to raise objections when necessary.

Risk culture is not static and should be actively challenged in order to encourage continuous improvement. Tools such as our risk culture diagnostic foster this cycle of continuous improvement by allowing management to benchmark against other organisations, track own performance over time and provide results at a sufficiently granular level so that remedial action can be applied.

Change will not happen overnight, but we see Solvency II as an opportunity to make a step improvement on risk culture within insurance organisations. In order to do that, insurers need to grasp the opportunity now.

Further information

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