Risk Culture in today's business world

Airmic Academy

Frederick Gentile – Director of Risk Engagement
Willis Towers Watson GB Risk Management

June 9, 2020

Willis Towers Watson

Agenda

WELCOME

PRESENTATION

Q&A

WEBINAR CLOSE

Patrick Smith
AIRMIC

Frederick Gentile
Risk Engagement Director

- Regulatory requirements for risk management
- Exploring risk appetite
- Can a common approach to ERM be established across the business?
- How can you contribute and develop risk culture in your organisation

?

Patrick Smith
AIRMIC

10:00 - 10:05

10:05 - 10:45

10:45 – 11:00

11:00

One way of looking at Risk Management

“Why does a car have brakes?”

“A car has brakes so that you go fast. If you got into a car and you knew there were no brakes, you’d creep around very slowly. But if you have brakes, you feel quite comfortable going 65 miles an hour down the street.”
John Reed

Is ERM really effective?

“Insurers engaged in ERM are valued 16.7% higher than other insurers”

The Value of Enterprise Risk Management: Evidence from the U.S. Insurance Industry
Hoyt R, Liebenberg A. (2008)

The results show that firms with advanced levels of ERM implementation present higher performance, both as financial performance and market evaluation. Additional tests also corroborate the expectation that effective ERM systems lead to higher performance.

Enterprise risk management and firm performance: The Italian case
CristinaFlorio[a]GiuliaLeoni[b]

Each year University of California holds an Annual ERM Summit focused on their continuous effort in improving their ERM program by reducing their Cost of Risk.

Reduced the Cost of Risk from $18.46 per $1,000 of operating budget to $13.31 per $1,000 of operating budget.

Since 2003-2004 fiscal year, they have reduced Cost of Risk by $493 million dollars

https://www.erm-strategies.com/blog/wp-content/uploads/2012/03/ERM-Application-Case-Studies.pdf

Spectacular Failures?

"But it was filmless photography, so management's reaction was, 'that's cute—but don't tell anyone about it."

'The project was cancelled in December 2010, seven years after it had begun. At least £482 million will have been wasted, with no IT system delivered and as at March 2013, five of the nine regional control centres were empty and incurring maintenance costs.'

'while the CEO called for increased risk management, he never delivered. At the ……………..., the company opted for cheaper and easier solutions in order to save time and money both before and after the explosion in 2010.'

'In the period leading up to the conclusion of the Franchise Competition, there were a number of warning signs that the procurement process was at risk. Legal advisers subsequently raised concerns that the Department may not have been entitled to apply discretion to the value of the subordinated loan facility when they found out that this had occurred. This advice was not escalated to members of the board investment and commercial subcommittee, the Permanent Secretary or ministers.'

"Risk management was repeatedly overruled," she added. "It was a shame because back in 1998 they were in trouble, and there was no need for them to have gotten themselves back into that spot by 2008."

This was the fourth-largest investment bank in America, but in September 2008 the company filed for bankruptcy. With $639 billion in assets and $619 billion in debt, the bankruptcy was the largest in history.
The problems in the subprime market should have alerted the organisation, but some serious downplaying by the Chief Financial Officer meant the warning went unheeded. Instead, the credit crisis signaled the start of the downfall. On 15th September 2008, the bank filed for Chapter 11 bankruptcy.

Regulatory requirements for risk management

THE UK CORPORATE GOVERNANCE CODE JULY 2018

The board should carry out a robust assessment of the company's emerging and principal risks. Includes a description of its principal risks, what procedures are in place to identify emerging risks, and an explanation of how these are being managed or mitigated.

ISO31000:2018

Risk management — Guidelines

Principles, Leadership, emphasis on revision of process element, actions and controls at each stage of process, focus on feedback with external environment

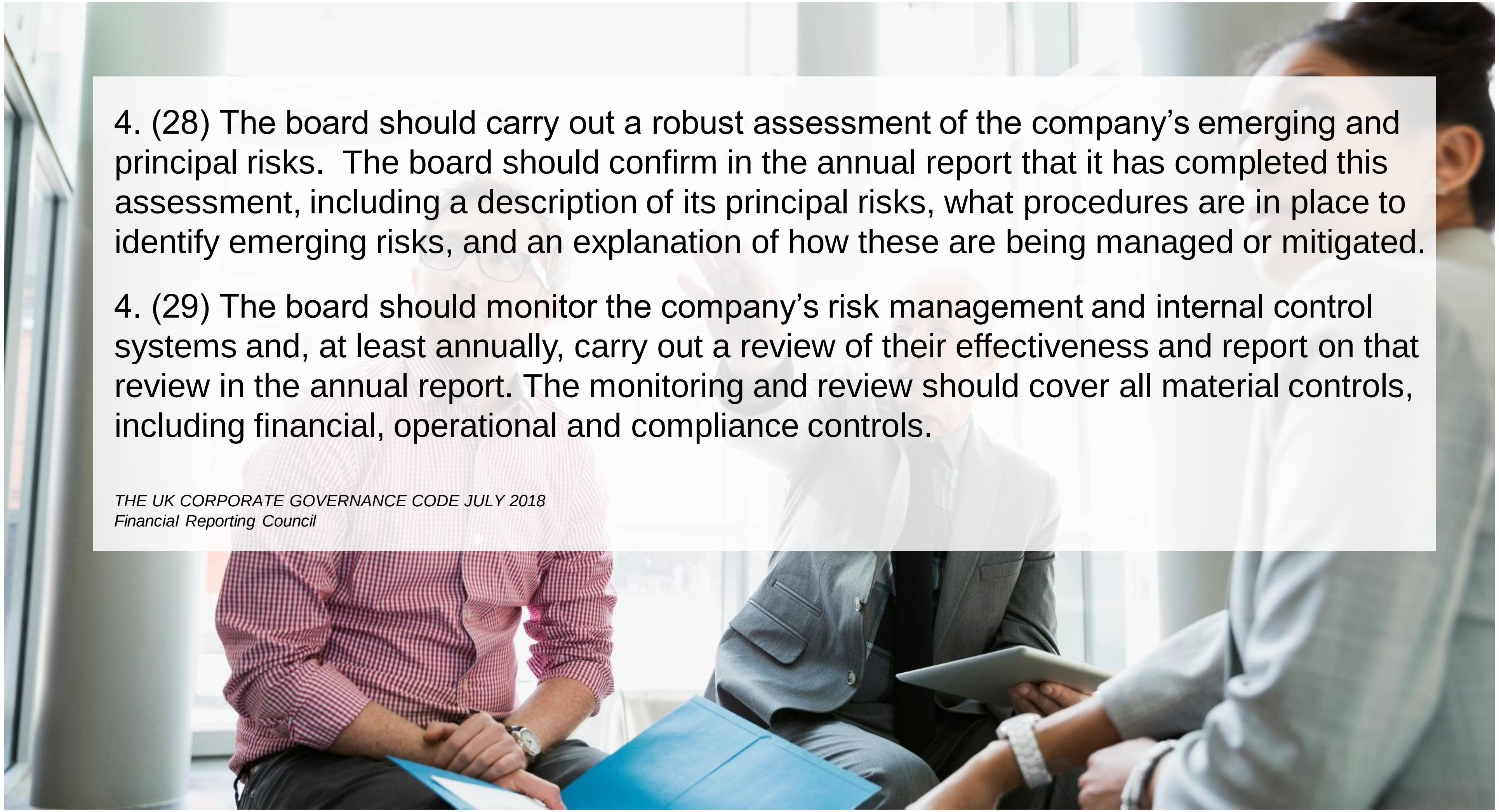
Companies Act 2006

Section 172 "director of a company must act in the way…. and in doing so have regard (amongst other matters) to the likely consequences of any decision in the long term.

Companies (Miscellaneous Reporting) Regulations 2018

now requires all companies of a significant size, that are not currently required to provide a corporate governance statement to disclose their corporate governance arrangement.

Financial Reporting Council Requirements (UK Corporate Governance Code)

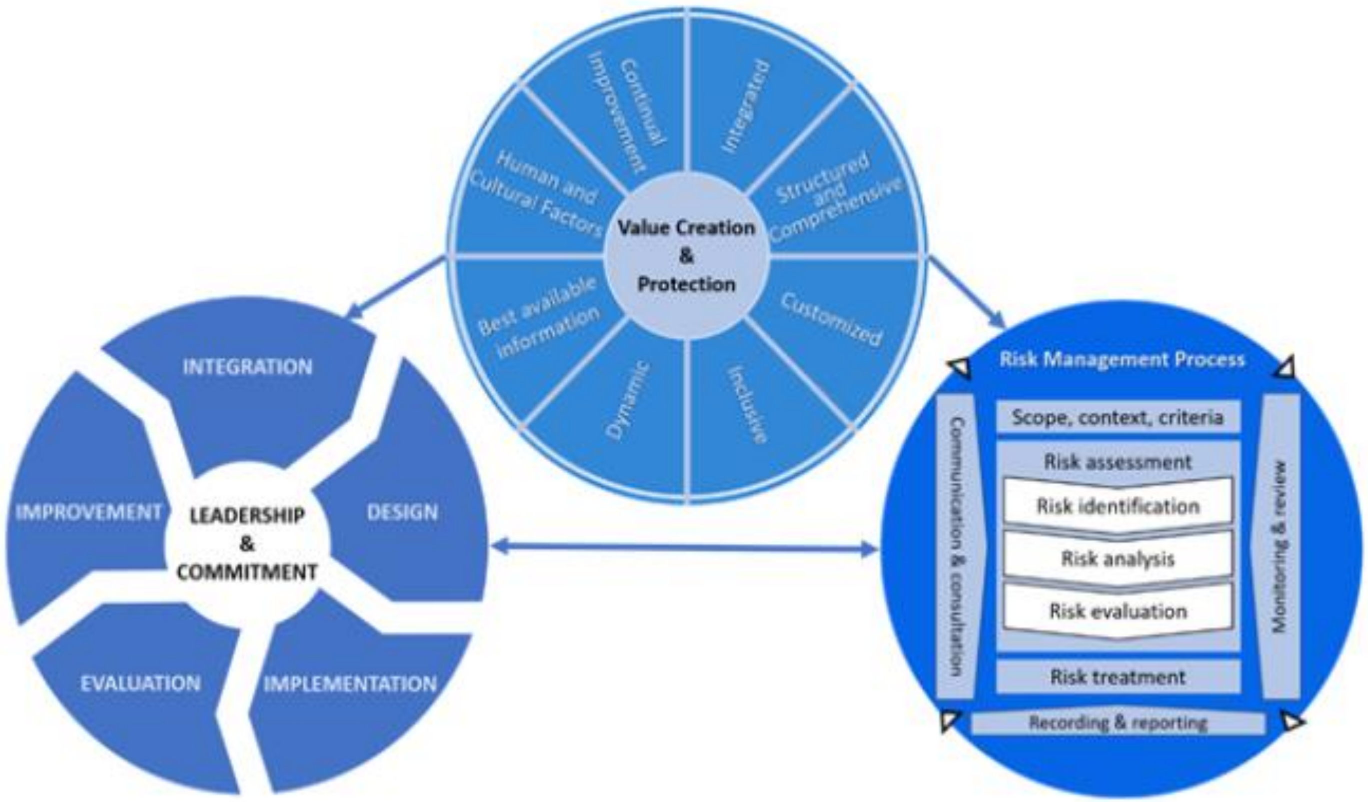


4. (28) The board should carry out a robust assessment of the company’s emerging and principal risks. The board should confirm in the annual report that it has completed this assessment, including a description of its principal risks, what procedures are in place to identify emerging risks, and an explanation of how these are being managed or mitigated.

4. (29) The board should monitor the company’s risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.

THE UK CORPORATE GOVERNANCE CODE JULY 2018
Financial Reporting Council

ISO 31000:2018



International Standard BS ISO 31000:2018

Risk Appetite

The Risk Appetite Statement sets the financial and non-financial limits or thresholds against which an organisations exposure to the major categories of risk can be controlled, measured, communicated and reported.

These major categories of risk will vary but typically include Financial, Operational, Compliance and Strategic.

The Risk Appetite Statement:

- Defines the level and types of risk an organisation is willing to accept in pursuit of strategic objectives
- Establishes risk escalation and reporting requirements in instances where the risk appetite is breached
- Is developed with input from senior management and approved by the ERM Committee and Board
- Applies to client-specific key risk areas on an organisation-wide level.

> *"The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives."*
>
> *THE UK CORPORATE GOVERNANCE CODE*
> *Financial Reporting Council, July 2018*

Risk Appetite examples

Our risk appetite is reviewed annually as part of the strategy review process and approved by the Board. This evaluation guides the actions we take in executing our strategy. We have identified a suite of Key Risk Indicators (KRIs) and defined specific tolerances for each (summarised below). These are reviewed quarterly by the Risk Committee, to ensure that the activities of the business remain within our risk appetite and that our risk exposure is well matched to changes in our business and our markets. These include the most significant judgements affecting our risk exposure, including our investment and development strategy; the level of occupational and development exposure; and our financial leverage.

Whilst our appetite for risk will vary over time and during the course of the property cycle, in general we maintain a balanced approach to risk. The Board considers our overall risk appetite in the year is broadly unchanged from last year. Having over the last few years lowered our financial risk we are now prepared to accept an increase in our risk relating to the more operational nature of property, reflecting market trends and our strategy as we build an increasingly mixed use business. Given the backdrop of economic and political challenges, we have actively managed our incremental risk exposure by:

- maintaining a limited exposure to speculative development coupled with our successful pre-letting strategy
- continuing to take a thoughtful approach to capital allocation, demonstrated by selling £1.5bn of mature and off-strategy assets, reinvesting partly in our share buyback programme, selective acquisitions and profitable development, whilst reducing our LTV further to 28.1%, despite valuation falls
- maintaining substantial financial headroom with £1.8bn of committed unsecured revolving bank facilities, of which £1.5bn is undrawn. Based on our current commitments, these facilities and debt maturities, we have no requirement to refinance until late 2022.

https://www.britishland.com/about-us/governance/risk-management/risk-appetite

Risk Appetite examples

The Company has developed a risk appetite framework that reflects three distinct lenses: Strategic Risk Appetite, Operational Risk Appetite and Conduct Risk Appetite. These three lenses aim to capture the range and variety of risks that the Company will be exposed to, with specific risk appetite parameters identified and monitored for each lens.

The Strategic Risk Appetite lens is focused on current and future portfolio considerations, taking into account parameters such as country concentration or exposure to higher-risk countries. It also considers “long range” developments to monitor key assumptions or beliefs in relation to energy markets. The Operational Risk Appetite lens is focused on more material operational exposures and promotes both a more granular assessment of key risks that the organisation faces and the purposeful assessment of risk appetite. The Conduct Risk Appetite lens brings together a number of leading and lagging risk indicators, which help to provide a more holistic view of the culture of the organisation.

The financial framework sets certain boundary conditions in the consideration of risk appetite, as the financial resilience of the Company should logically inform the aggregate level of risk appetite that could be sustained.

https://reports.shell.com/annual-report/2018/servicepages/search.php?q=risk+appetite&pageID=97611

Risk Appetite examples

LLOYDS BANKING GROUP

Our principal risks

Principal risks and uncertainties are reported regularly to the Board Risk Committee. Change/execution, data and operational resilience have been elevated from existing risks to principal risks during 2019, and strategic added as a new principal risk

NEW — CHANGE/EXECUTION

The risk that, in delivering our change agenda, we fail to ensure compliance with laws and regulation, maintain effective customer service and availability, and/or operate within our approved risk appetite.

Example
Ineffective change/execution risk management could lead to increased periods of time where we cannot serve our customers, and could lead to impacts associated with other risk types such as regulatory censure.

Risk Appetite
We have limited appetite for negative impacts on customers, colleagues, or the Group as a result of change activity.

Mitigation
- Continued focus on strengthening the control environment, maturation of the change policy and associated policies and procedures, which set out the principles and key controls that apply across the business and are aligned to the Group risk appetite. Senior Management continue to drive improvements to Change and Execution Risk metrics, in particular those affecting customers and colleagues
- Businesses assess the potential impacts of undertaking any change activity on their ability to execute effectively, and the potential consequences for the existing risk profiles

Further detail on principal risk, including mitigation on page 139

NEW — DATA

The risk that we fail to effectively govern, manage, and control our data (including data processed by third party suppliers) leading to unethical decisions, poor customer outcomes, loss of value and mistrust.

Example
The loss of trust from customers, colleagues, business partners or regulators arising from a failure to manage and control our data.

Risk Appetite
We have limited appetite for material events or losses that occur due to the inappropriate use of data.

Mitigation
- Significant investment has been made to enhance the maturity of data risk management in recent years
- In addition to the General Data Protection programme which delivered the necessary infrastructure to achieve compliance with the new regulations in May 2018, a number of other large investments have been made

Further detail on principal risk, including mitigation on page 139

Alignment to strategic priorities and future focus

Delivering a leading customer experience

- The quality of the data that the Group holds and the choices we make in how it is used is a key strategic enabler to future business

NEW — OPERATIONAL RESILIENCE

The risk that we fail to design resilience into business operations, underlying infrastructure and controls (people, process, technology) so that it is able to withstand external or internal events which could impact the continuation of operations, and fails to respond in a way which meets customer and stakeholder expectations and needs when the continuity of operations is compromised.

Example
Ineffective risk management could lead to vital services not being available to customers and stakeholders.

Risk Appetite
We have a limited appetite for disruption to services to customers and stakeholders from significant unexpected events.

Mitigation
- The Group has increased its focus on operational resilience and has updated its strategy to reflect changing priorities of both customers and regulators

Further detail on principal risk, including mitigation on page 140

Alignment to strategic priorities and future focus

Delivering a leading customer experience

- End-to-end resilience of our critical processes is a key strategic priority and the Group operational resilience programmes continue to invest in improving our control

https://www.lloydsbankinggroup.com/globalassets/documents/investors/2019/2019_lbg_annual_report_v3.pdf

Risk Appetite examples

Descriptors of Corporate Risk Appetite in [redacted] - Internal focus

Description of Appetite WJBP themes	Associated risk register impact category	Averse	Very Cautious	Cautious	Open	Bold
Customer Provide excellent customer service **Reliability** To keep power flowing to our customers 24 hours a day, 7 days a week	Customer Service	[redacted] will outperform all performance commitments in relation to customer satisfaction and reliability. [redacted] has no tolerance for risks which could prevent it from reaching top position in the CSAT league table.	[redacted] will achieve all performance commitments in relation to customer satisfaction and reliability. [redacted] will reach upper quartile performance in the CSAT league table within the 3 year customer road map.	[redacted] will tolerate non achievement of a very small number of performance commitments in relation to customer satisfaction and reliability. [redacted] will reach upper quartile performance or strong second quartile performance, potentially in a longer timeframe than the 3 year road map.	[redacted] will tolerate non achievement of a number of performance commitments in relation to customer satisfaction and reliability in pursuit of longer term improvement. This could result in shorter term second quartile performance within the CSAT league tables.	[redacted] will tolerate a moderate level of reduced performance against all its customer satisfaction and reliability commitments in pursuit of longer term improvement. This could result in shorter term second or third quartile performance within the CSAT league tables.
Affordability To keep our costs down for our customers/cost savings (Including RIIO incentive mechanism)	Financial	[redacted] has no tolerance for any risk that may result in loss or financial exposure of more than £2m OPEX in one year, £1m CAPEX on an individual scheme or £10m over RIIO-ED1, or a breach of the financing agreements or covenants. It will only pursue income generation opportunities or cost saving initiatives with a very high probability of return.	[redacted] has low tolerance for any risk that may result in loss or financial exposure more than £2m OPEX in one year, £1m CAPEX on an individual scheme or £10m over RIIO-ED1. It will consider some risks that may result in a breach of financing agreements. It will only pursue income generation opportunities or cost saving initiatives with a high probability of return.	[redacted] is willing to accept some risks that may result in loss or financial exposure more than £2m OPEX in one year, £1m CAPEX on an individual scheme or £10m over RIIO-ED1. It will only pursue income generation opportunities or cost saving initiatives with a moderate probability of return.	[redacted] is willing to accept opportunities that have some inherent risk and may lead to moderate financial loss, more than £2m OPEX in one year, £1m CAPEX on an individual scheme or £10m over RIIO-ED1. It will pursue income generation opportunities of cost saving initiatives with a low to moderate probability of return.	[redacted] is willing to accept opportunities that have a high inherent risk and may lead to substantial financial loss, more than £2m OPEX in one year, £1m CAPEX on an individual scheme or £10m over RIIO-ED1. It will pursue income generation opportunities of cost saving initiatives which may generate a return but have a high level of risk.
Sustainability To maintain our network now and for future generations	Reputation / Compliance (Legal & Regulatory Performance / Environment)	[redacted] will be recognised as best in class, respected as the industry leader nationally. It will not tolerate local media, stakeholder or customer criticism. [redacted] is recognised by stakeholders as demonstrating exceptional levels of compliance. It will not tolerate any breach that results in an undertaking or fines/recovery/reputational damage.	[redacted] will be seen as an established upper quartile performer, respected across the industry and nationally. It will only tolerate one-off local media, stakeholder or customer criticism. [redacted] is a compliant organisation. It will only tolerate minor breaches that do not result in an undertaking or fines/recovery/reputational damage.	[redacted] wants to be an upper quartile/strong second quartile performer, respected across the industry and region. It will tolerate periodic local media, stakeholder or customer criticism. [redacted] is a compliant organisation. It will only tolerate one-off minor breaches of regulation in the pursuit of guaranteed improvement in compliance, resulting in minor reputational damage in the eyes of stakeholders.	[redacted] wants to be seen as a strong second quartile performer, respected across the industry. It is willing to accept sustained instances of negative exposure in the local press (or even one - off criticism in the national press) to support the achievement of objectives. [redacted] is a compliant organisation. It will only tolerate one-off, minor breaches of regulation in the pursuit of guaranteed improvement in compliance, resulting in an undertaking or fines or recovery of more than £0.5m.	[redacted] wants to be seen as a solid performer (second/third quartile). It is willing to accept periodic negative exposure in the national media to support the achievement of objectives. [redacted] is a compliant organisation. It will only breach regulation or statute resulting in an undertaking or fines or recovery of more than £1m in pursuit of long-term improvement in compliance.

Water Utility

'Network Rail has no appetite for safety risk exposure that could result in injury or loss of life to public, passengers and workforce.
Safety drives all major decisions in the organisation. All safety targets are met and improved year-on-year. In the pursuit of its objectives, Network Rail is willing to accept, in some circumstances, risks that may result in some financial loss or exposure including a small chance of breach of the loan limit. It will not pursue additional income generating or cost saving initiatives unless returns are probable. The company will only tolerate low-to-moderate gross exposure to delivery of operational performance targets including network reliability and capacity and asset condition, disaster recovery and succession planning, breakdown in information systems or information integrity.
The company wants to be seen as best in class and respected across industry. It will not accept any negative impact on reputation with any of its key stakeholders, and will only tolerate minimum exposure ie, minor negative media coverage, no impact on employees, and no political impacts.'
Network Rail Limited, Annual Report and Accounts 2015

Some approaches to setting Board level risk appetite

Qualitative approach

Using organizational core principles to set the bars e.g.

"No tolerance for risks that may cause injury or endanger life"

"Grow business by acquisition, development and our active asset management strategy. This focus on our core strengths is balanced by a more cautious approach to risk in other areas.

Quantitative approach

Adopting defined metrics e.g.

"No tolerance for any risk that exposes us to a loss of £10m> EBITDA"

"No tolerance for failure to comply with DWI reg 28 notice"

Priority based

For example

"The Board has agreed five levels of risk priority and demands that risk appearing at the highest priority i.e. Very High does not fall within our risk appetite and must receive immediate and urgent attention and be referred to the Board"

Standard linked

Aligning Risk Appetite to a regulator requirement e.g. Ofwat's 'Resilience in the Round' framework

Case Study

Our client, a well known utility plc, has a well established Risk management framework. However, defining and agreeing Risk Appetite has always proved a challenge at Board level.

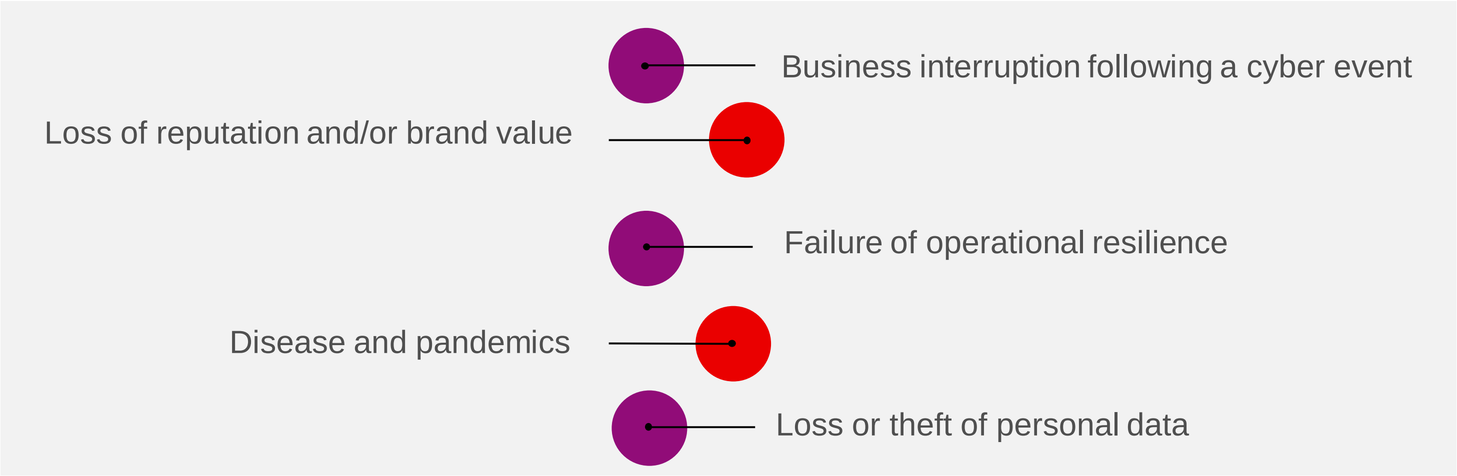
We were asked to provide support on this requirement.

Our initial approach was to suggest a quantitative based approach but this was deemed unsuitable given the wide variety of operations carried out by the company.

We then proposed a qualitative solution based on gauging views on risk and appetite from key functions at Board level. Once information has been collated and processed against existing company risk parameters a draft risk appetite statement would be prepared for presentation to the Board.

This solution was well received and we are currently carrying out the individual Board member interviews.

What does our risk landscape look like today?

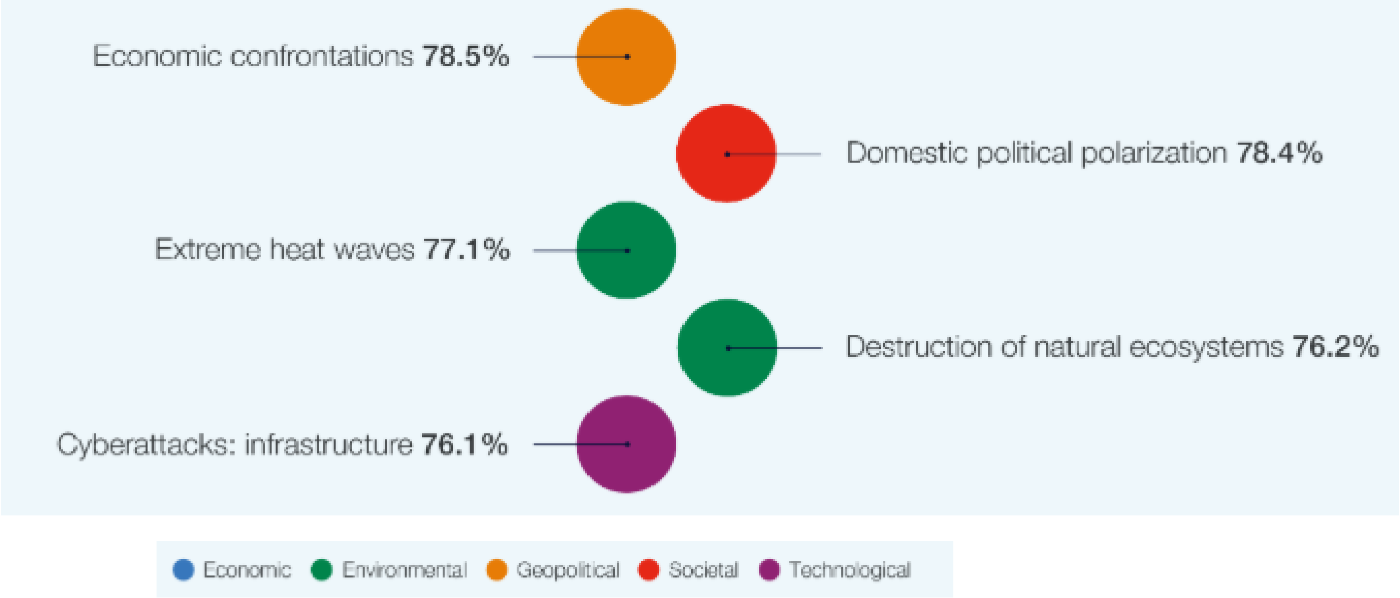


AIRMIC top five front-of-mind risks

2020 Airmic annual survey

World Economic Forum Short Term Risk Outlook

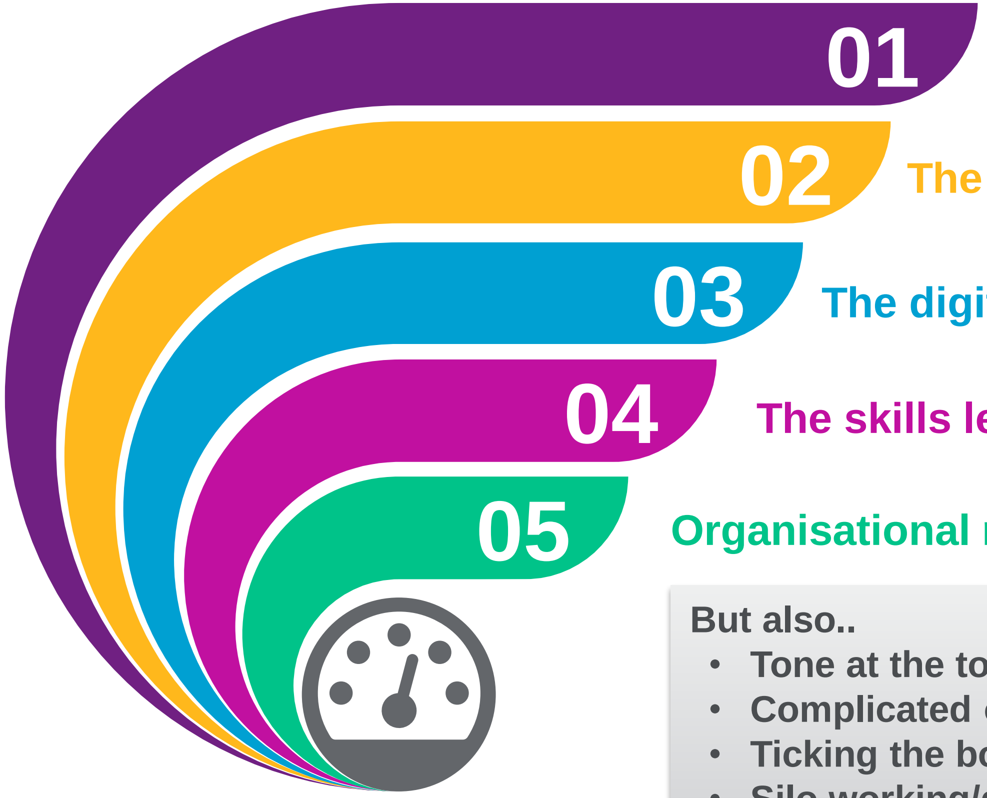
http://reports.weforum.org/global-risks-report-2020/shareable-infographics/



Risk Culture

Barriers to ERM (new processes/technologies)

Top 5 AIRMIC results



01 The level of investment needed

02 The perceived lack of added value

03 The digital maturity level in the organisation

04 The skills level within the department

05 Organisational resistance to internal change

But also..

- Tone at the top
- Complicated or infrequently used systems
- Ticking the box
- Silo working/different agendas
- Cultural resistance (What is it? Why do I need to do it?)
- Multiple jurisdictions

Source: 2020 Airmic annual survey

Overcoming Barriers

- **Integrate risk management across disciplines** e.g. BCM, H&S, Audit
- **Get the basics right** A commonly agreed framework setting out role, responsibilities, benefits and processes, responsive event monitoring
- **Board ownership** if senior management don't believe the process is destined to fail
- **Challenge the norm** i.e. are risks still current? Are the scores valid? What about interdependencies?
- **Broaden horizons** consider/evaluate Geopolitical risks, Black Swan events, extending time horizons
- **Stress Testing** Assess risk impact & assumptions through scenario modelling
- **Communicate, Communicate, Communicate!**

Can a common approach be established?

‘This document provides a common approach to managing any type of risk and is not industry or sector specific’

(BS ISO 31000:2018, 1. Scope)

But remember ….

- The Risk Management process must be culturally aligned to the organisation.
- There must be buy-in at all levels.
- You must demonstrate cost effectiveness.
- The benefits need to be as tangible as possible.
- Whatever the process or approach ultimately it is about people.

Closing thoughts

Doing nothing is not an option

You have to understand your new risk environment

Engage
Communicate
Demonstrate

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Each applicable policy of insurance must be reviewed to determine the extent, if any, of coverage for COVID-19. Coverage may vary depending on the jurisdiction and circumstances. For global client programs it is critical to consider all local operations and how policies may or may not include COVID-19 coverage.

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