The term ‘risk’ is being used with increased frequency and reflects the importance that diverse areas of the economy are placing on effective risk management. Sectors such as oil and gas, healthcare and banking are realising that, if they are to thrive, they need to exploit the opportunities presented by desirable risks and control the threats from undesirable risks. Additionally, a number of well-publicised risk management failures, including in the financial services sector, have increased the focus on the need for good risk management practices.

Risk is a particularly important concept for the insurance industry, although not a new one. The management of risk has always been a key part of the business of insurance and there is much expertise within the industry. This expertise has often been confined to specialist areas and traditionally risk management has not been seen as part of everyone’s day-to-day responsibility. This view is gradually changing and the desire to achieve real benefits from effective risk management has led to the introduction of Enterprise Risk Management (ERM) in many companies.

The growing awareness of the need to better understand and manage all of the risk exposures in insurance companies has resulted in changes to the regulatory environment in recent years.

The existing solvency regime in the EU, Solvency I, does not link the solvency capital requirement to the risk exposures within the company and, given this weakness, is to be replaced. In the UK, Solvency I has been supplemented by ICAS, which provides an improved risk-based approach to capital management. Solvency II, the successor to both regimes, will introduce a regulatory environment with risk management at its core and will require companies to integrate risk and capital management considerations into their business decision making. The Own Risk and Solvency Assessment (ORSA) is a requirement under Solvency II and provides a comprehensive assessment of the capital required by the company, taking into account its risk profile.

The insurance industry today is complex with many challenges, and the market is very competitive. Companies need to find potential areas for commercial advantage and maximise the benefits. BaxterBruce are regularly speaking to companies who appreciate that one way to do this is to develop a better understanding of the risk exposures within their company and align the capital held to the underlying risks in the most efficient manner. This can only happen if ERM is fully embedded within the company and is seen as an enabler for the business. There are real potential benefits for a company from effective risk and capital management, which far exceed simply meeting the regulatory requirements.
Insurance companies are experts in risk assessment. Often this has been seen as the responsibility of the ‘compliance’ areas and not the ‘operational’ areas. The approach under ERM is different – risk management is seen as everyone’s responsibility and demands a greater understanding of all aspects of risk so that the company can accept risks where they are seen as desirable and avoid risks that may be detrimental. In this way, risk management supports the company in achieving its business objectives and can be viewed as an enabler to meet business goals rather than as an inhibitor to business development.

Across the industry, the importance of ERM is demonstrated by the resources devoted to building the company’s capabilities. In most companies, the Chief Risk Officer (CRO) takes responsibility for ERM, reporting directly to the Chief Executive Officer (CEO) and the Executive Board. The CRO will look across the company and develop a view on its risk profile and how that risk profile matches its risk appetite. They will then ensure that risk management is carried out on a day-to-day basis by the first line of defence. This requires the correct people, processes and systems to be in place to enable ERM to become embedded in the company.

ERM is required to meet regulatory requirements but is increasingly required to meet best practice in the industry and to remain competitive in a difficult market environment. Implementing and embedding ERM is challenging but will contribute to enhanced business performance and provide real benefits for the company. In essence, ERM provides a unified view of risk within the company and can be established in a way that reflects the specific needs of each company. In companies that have successfully implemented ERM it lies at the heart of proactive risk-adjusted decision making and the effective management of capital.

The diagram illustrates the key considerations required to support ERM including appropriate risk governance, effective operational support, strong links between ERM and the decision making processes, and an understanding of what is happening in the wider environment. The ERM Life Cycle shows the continuous activities that are required, namely to identify, measure, monitor, manage and report the risks to which the company is exposed.

<table>
<thead>
<tr>
<th>Challenges When Implementing ERM</th>
<th>Benefits of Implementing ERM</th>
</tr>
</thead>
<tbody>
<tr>
<td>A company can come up against many challenges when implementing ERM including:</td>
<td>The benefits for a company from implementing an effective ERM framework are invaluable including:</td>
</tr>
<tr>
<td>➤ Requires considerable commitment of resources and is time-consuming</td>
<td>➤ Enables decision making to be based on a better understanding of the risks</td>
</tr>
<tr>
<td>➤ Essential that integrates with, and complements, the way the business currently operates</td>
<td>➤ May lead to an increase in risk-adjusted profits as a result of more effective risk management practices</td>
</tr>
<tr>
<td>➤ Will sometimes require significant changes to the way people work</td>
<td>➤ Involves proactive risk management, as opposed to reactive risk control.</td>
</tr>
<tr>
<td>➤ Strong leadership and clear commitment from senior levels is essential</td>
<td>➤ Ensures consistent treatment of, and responses to, risk</td>
</tr>
<tr>
<td>➤ May be difficult to source appropriate data to fully understand the risks</td>
<td>➤ Encourages companies to take a longer term outlook on risk</td>
</tr>
<tr>
<td>➤ Reporting must be timely and insightful, in order to support proactive decision making</td>
<td>➤ Results in a greater awareness of the trade-off between risk and return</td>
</tr>
<tr>
<td>➤ Management of operational risk is often particularly difficult</td>
<td>➤ Allows companies to react more quickly to emerging risks</td>
</tr>
<tr>
<td>➤ Embedding ERM throughout the company is a major undertaking</td>
<td>➤ Capital requirement can be more accurately determined and may reduce</td>
</tr>
</tbody>
</table>
The Key Elements of ERM

Having explored the main drivers for implementing ERM, and the key challenges and benefits, a successful ERM implementation involves much more than the introduction of a sequence of activities that must be carried out. It requires a step change in the attitude to risk in the company, and an acceptance that risk is everyone’s responsibility.

There are certain key operational aspects that need to be in place in order to embed ERM into business-as-usual in the company. These include:

- **People and behaviours** – who support ERM and are contributing to a positive risk culture
- **Processes** – are appropriate throughout the company
- **Systems** – to make the required processes manageable.

### 1. People and Behaviours

A fundamental requirement for successful ERM is a good risk culture. This is effectively the behaviours of the people in the company. The company can encourage and influence appropriate behaviour in a number of ways, including:

- Recruiting people with the desired core values
- Encouraging open communication and transparent activity
- Providing clear responsibilities and boundaries within which decisions can be made
- Demonstrating commitment from the top
- Training and developing staff
- Rewarding appropriate behaviour through performance management.

Effective risk governance should result in everyone understanding that they have an important role to play in ERM and the nature of their specific role. Responsibilities in the company can be divided into either risk taking, risk oversight or risk assurance.

### 2. Processes

The ERM framework will set out certain key operational processes that need to be carried out in order to deliver effective ERM. Foremost among these is the agreement of the appropriate risk strategy and risk appetite for the company by the Board. This will determine the parameters within which the risk takers in the company will operate.

The ERM life cycle comprises of five key stages of identifying, measuring, monitoring, managing and reporting the risks in the company. Each of these stages is significant and will require considerable effort from the relevant areas. The ORSA is also a vital component of ERM, linking the company’s risk management framework to its business strategy and decision-making strategy. The enhanced understanding on the risk exposures that are gained from ERM should be utilised in business planning, capital management, product development and strategic decision making, to ensure that the company benefits fully from ERM.

### 3. Systems

Delivery of ERM would not be possible without the supporting technologies. The ERM processes are potentially very time-consuming and require appropriate systems to allow them to be manageable.

Risk modelling systems are needed to carry out complex calculations, to quantify the risk exposures in the business, to assess the impact of stress tests and to aggregate the risks. Risk monitoring systems are used to analyse risk exposures, monitor any changes in risk exposures and to check that risk exposures remain within the risk appetite limits. Risk reporting systems then provide a summary of key risk data, aggregate data where necessary and produce risk dashboards to highlight important messages.

**In Summary**

- ERM is a complex subject, but the fundamentals can be made accessible to all
- ERM is not an optional extra, but rather an essential management tool
- Everyone in the company needs to understand ERM, and why it is important
- ERM must be embraced throughout the company, at all levels and in all areas
- Embedding ERM is challenging, but the benefits are worthwhile
- It is crucial to provide training and education to everyone within the company.

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BaxterBruce’s ERM eLearning solution comprises an online training module specifically designed to provide an overview of the key aspects of ERM. The course is:

- **Suitable for all** – designed to be rolled out across an entire insurance company to enable everyone to gain a broad understanding of ERM
- **An appropriate length** – should take less than an hour to complete
- **Engaging and effective** – a combination of interactive material, quality media and audio ensures that the content is engaging and effective
- **Examinable** – an on-line assessment to validate learner understanding is included
- **Simple to implement** – available ‘off the shelf’ with little lead time before learners can begin using
- **Able to be tailored** – provides the facility to tailor content to ensure company specific requirements are adequately incorporated.

The course curriculum assumes no prior knowledge of ERM and introduces the learner to six key topics:

- **Enterprise Risk Management** – the basics of ERM including what it means, the objectives, the components and the importance of a good risk culture
- **Governance** – the importance of risk governance, the ‘three lines of defence’ model, risk committees and risk policies
- **Life Cycle** – the components of the risk life cycle (identify, measure, monitor, manage, report) and risk categories
- **Operations** – the important role everyone in the company has to play in ERM and the contribution of people, processes and technology to successful delivery of ERM
- **Business Decision Making** – how ERM links to decision making, the typical decisions that need to be made and the business benefits of enhanced decision making
- **The Wider Environment** – changes in the regulatory regimes, the ORSA requirements and market developments.

BaxterBruce offers insurance companies a broad range of services across the areas of Risk & Capital Management, Regulatory Change, Programme Delivery and Change Management. We combine industry insight and deep functional knowledge with extensive delivery expertise to help our clients meet their strategic goals.

Our Services

1. **Risk & Capital Management**
   designing and implementing practical frameworks and tools focused on optimising risk and capital related business decisions
2. **Programme Mobilisation & Delivery**
   applying the experience and structure necessary to setup and execute complex programmes of change and provide independent project assurance
3. **Organisation & Change Management**
   building a comprehensive approach to supporting people through the change journey so that they are ready, willing and able to embed new ways of working
4. **Insurance Operating Model Design**
   combining best practice insight to help design and deliver the end-to-end capabilities required to achieve an organisation’s vision for the future
5. **Regulatory & Compliance**
   providing thought leadership and pragmatic delivery expertise to support organisations meet regulatory and compliance requirements.

Our Clients

Our clients are those that seek an alternative to typical business consulting firms: a genuine business partner that can provide industry leading expertise, who remains focused on the project brief and who concentrates on providing services in the areas in which they are strongest.

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