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# Charting the Evolving Role and Authority of the CRO

## 2016 Ernst & Young Insurance CRO survey

**By Chad Runchey and David Paul**

### INTRODUCTION

EY's Insurance Risk Management Team has run an annual survey of Chief Risk Officers (CROs) since 2010. Over the period, the survey has charted the evolving role and authority of insurance CROs, as well as the development of Enterprise Risk Management (ERM) capabilities generally.

The 2016 survey was larger than in previous years, with more participating organizations and greater diversity among them.

Sector:

| |
|---|
| P&C: 55% |
| Life: 35% |
| Composite: 10% |

Survey participants ranged from large global organizations with multiple regulatory regimes (including US Federal Reserve Board oversight) to midsized national carriers with only state Department of Insurance (DOI) regulators.

The interviews for the 2016 survey were held between December 2015 and April 2016. This article highlights some key outputs and summarizes four of the key themes of the survey: maturation of risk management; CRO roles, responsibilities and reporting lines; ORSA—one year in; and risk appetite. The complete survey and its full findings can be found at *http://www.ey.com/us/en/industries/financial-services/insurance/ey-2016-north-american-insurance-cro-survey*.

The increasing influence of ERM is being earned on its own merits.

### MATURATION OF RISK MANAGEMENT

This year's survey revealed a spectrum of maturity levels of ERM programs—from very impressive frameworks that are integral to and influential in how the business is run, to others that are limited in scope and formality. To a degree, this variety reflects the inclusion of a broader and more diverse group of participants in the 2016 survey, compared with past years.

The survey also clarified the role that companies expect CROs to perform. Where ERM structures are advanced, CRO are very senior officers and participate in decision-making at the highest levels of the organization. At the other end of the continuum, the survey included several insurers that do not have a single, titled CRO role, though there may be an officer leading ERM efforts. More robust ERM programs have typically been in place for a few years and are now fully embedded as part of routine business operations, while late adopters struggle to define the ideal role, structure and prominence of their risk teams.

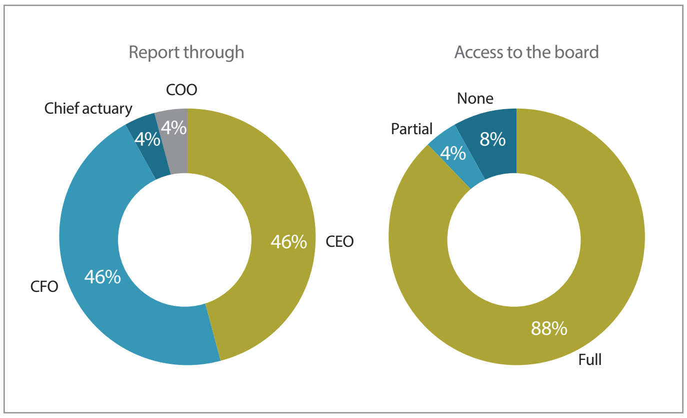
Interestingly, despite the varying levels of sophistication and formality, all survey respondents felt their organizations have adequate processes to manage the risks to their business. In some cases, there was a degree of complacency where risk management capabilities did not seem sufficiently developed. There were just as many examples, however, where risks are very effectively monitored, controlled and mitigated without the recognizable or formalized superstructure that is often associated with "modern" ERM.

## CRO ROLES, RESPONSIBILITIES AND REPORTING LINES

One of the objectives of the 2016 survey was to assess the current roles and responsibilities of CROs. The general trend seen was toward larger roles and increasing responsibility, much of it occurring at the senior management level and with a broader range of stakeholders across the business. The results also revealed the most prevalent organizational structures, along with interesting variety in the shapes and sizes of risk teams.

**Governance structure:** Most CROs report directly to either the CFO or the CEO. *See Figure 1* In a few cases, the CRO reports through another position, such as the chief actuary or COO. The independence of CROs has been a frequent topic of discussion in recent years. Most CROs have full access to the board and attend quarterly risk committee meetings. Many also attend board subcommittee meetings, such as the audit committee. In organizations where the CRO reports to the CFO, the independence of the risk management function is less clear.

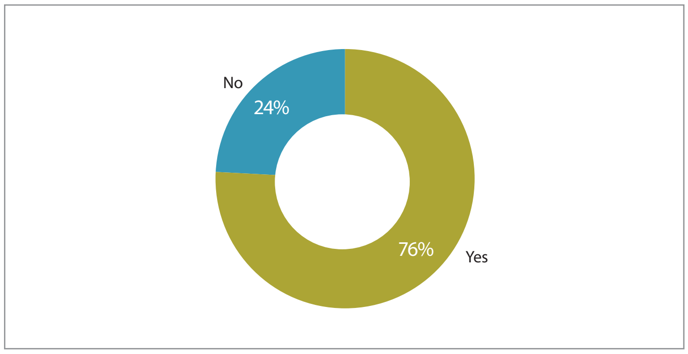
Figure 1
Reporting Lines and Board Access




**Three lines of defense:** The “three lines of defense” model has become the norm for most of the financial services industry, and more than three-quarters of survey respondents reported its formal adoption at their organizations. *See Figure 2* Many of the organizations that have not implemented the model indicated it is unnecessary, too bureaucratic or costly. These organizations were also unlikely to adopt “three lines of defense” in the near future and were not subject to regulatory requirements to adopt it.

Organizations that aspire to adopt the model reported challenges in demarcating the three lines, particularly where first- and second-line responsibilities reside with the same officer. Some survey participants seemed slightly complacent when compared with peers who have made strides in governance to ensure proper independence for the risk management function.

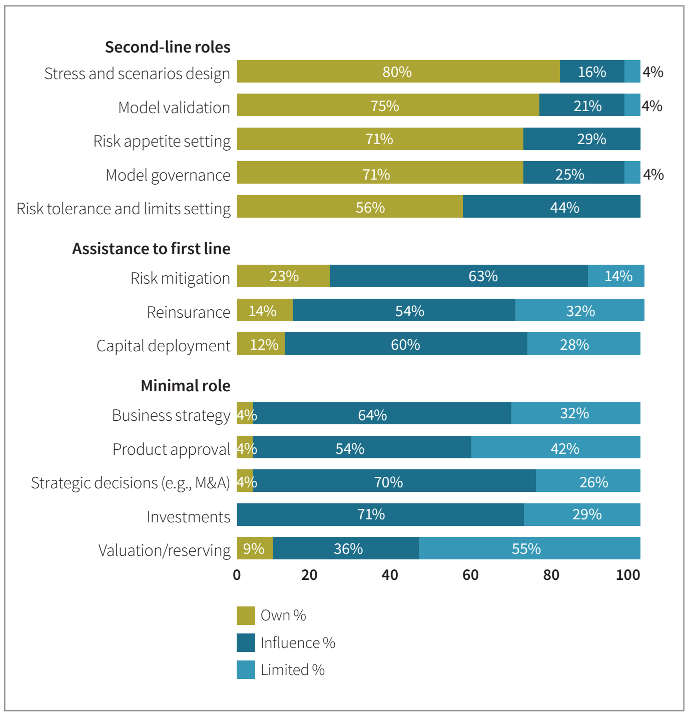
Figure 2
Formal Adoption of a Three Lines of Defense Model




**CRO roles and responsibilities:** In terms of CRO responsibilities, there are varying degrees of influence across a range of activities. It was somewhat surprising that not all second-line roles (such as model validation and risk appetite setting) were fully owned by CROs. *See Figure 3*

For capital deployment, strategy, product approval, reinsurance, risk mitigation and reserving, most CROs have influence but not ownership. This finding aligns with the second line of defense’s increasing role as an “effective challenge” to decisions made by the first line.

Figure 3
Role of the Risk Function



## ORSA—ONE YEAR IN

In late 2015 and early 2016, many insurers submitted their Own Risk Solvency Assessments (ORSA) filings to their state regulators for the first time. As such, the survey results indicate how state regulators are working with insurers with their ORSA submissions.

**ORSA's value:** Comments from survey participants suggested the range of ways ORSA can produce current or future value. For instance, one CRO commented that having the ORSA report as a reference significantly shortened state-level audit procedures this year. For some insurers, ORSA highlighted gaps in risk management processes and capabilities and clarified opportunities to refine governance and committee structures. One respondent commented that the "internalization" of stress and scenario impacts allowed them to think about management responses more proactively.

All companies involved their board in the ORSA process, in alignment with guidelines from the National Association of Insurance Commissioners, and some CROs reported their board's satisfaction with the report. Other firms used the ORSA as a source for employee education or as a single, centralized source for risk information.

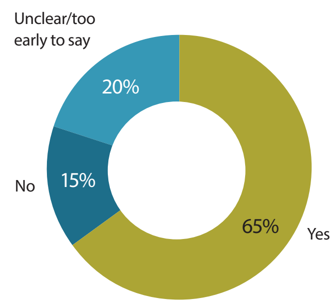
Some survey participants did not regard the arrival of the ORSA requirement as significant, in that it gives rise to a report on general ERM activities that companies were taking anyway. Other respondents described plans for streamlining the ORSA process in the future, implying that less laborious efforts could yield more value. This was particularly the case among those firms that were submitting multiple ORSAs (e.g., for different entities, for different states or for international operations).

**ORSA and the regulators:** At the time of the survey, not all participants had received feedback from regulators on their ORSA submission. Those that had feedback indicated the following areas as needing enhancement:

- Clearer linkages between risk appetite and stress testing
- Increased focus on risk identification
- More detail on stress and scenario testing
- Reverse stress testing to determine what would it take for company to default
- Validation of results
- Inclusion in ORSA of M&A activity
- Clarity over unique ORSA features at mutual insurers

The survey results and comments from participants indicate that regulators are also coming to terms with ORSA—no surprise given that this was the first official year for submissions. One respondent described a "learning curve" for regulators in determining the best way to use the content of the reports and determining an effective review process. But it was a majority view that ORSA improved overall regulator understanding of current risk management practices. *See Figure 4*

Figure 4
Better Regulator Understanding of Your Risk Management Practices as a Result of ORSA Report




## RISK APPETITE

Virtually all respondents commented that their company's risk appetite references both "economic" internal views of capital and regulatory requirements. *See Figure 5*. There was considerable variation in the internal view being used, with "economic capital" being defined in various ways by different companies.

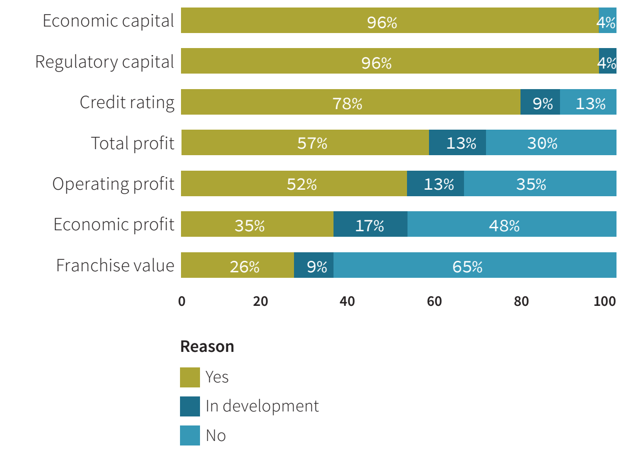
External credit ratings are the third most common metric referenced by risk appetites. This is particularly important in situations where insurers' potential customers place their business largely based on the rating of the carrier.

Profitability measures are becoming more common within risk appetites. These can be as simple as stating some fixed probability (or zero probability) of the business incurring a loss. Various companies use operating, total or "economic" profit. A number of respondents described active projects to develop greater use of profitability measures within risk appetites.

## CONCLUSION: CROs LEAD INSURERS FORWARD ON THE ERM JOURNEY

The 2016 survey results show that the influence of ERM programs, CROs and the risk teams they lead continued to grow in the 12 months since the 2015 survey. Participants reported incremental gains across a variety of areas: size of risk teams, access to senior management and boards, risk appetite setting, impact of the ORSA, quantification via stress testing, and capital modeling and risk reporting.

Figure 5
Metrics Used in Setting the Corporate Risk Appetite




**Others cited:**
Probability of making a loss /losing one year profit
RAROC
Managing catastrophe exposures
Changes in market value of assets
Leverage
Reputational risk
Legal and regulatory risks
Strategic risks

While 2015 brought required ORSA submissions for most survey participants, the process proved to be less of a hurdle than might have been expected. Many companies had already "upped their games" through the ORSA pilots of preceding years. Furthermore, survey participants saw little evidence of strong challenges from state regulators receiving the first round of ORSA submissions.

The cumulative results of the survey showed that, in the absence of regulatory drivers, the increasing influence of ERM is being earned on its own merits — a very good place for industry CROs to find themselves. ■

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