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Effective ERM Stakeholder Engagement

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This article summarizes some key points of the research paper entitled "Effective ERM Stakeholder Engagement." The paper can be found at https://www.soa.org/resources/research-reports/2018/effective-erm-stakeholder/.

Risk management has developed quickly in the past decade in the insurance industry and is playing a more important role in business decision-making. The evolution of risk management keeps bringing changes to existing business management. It takes time and resources for people to learn, understand, validate and finally agree on these changes.

CURRENT PRACTICE

To understand risk management professionals' experiences obtaining stakeholder engagement and current best practices for doing so, two surveys were conducted in the actuarial risk management community: a pilot survey and an online survey. The pilot survey targeted senior executives through phone and face-to-face interviews. The discussions were open-ended to collect ideas about the issues prevalent in ERM buy-in. An online survey was then sent out to the members of the Joint Risk Management Section (JRMS) and the International Network of Actuarial Risk Managers (INARM). Risk officers (both internal and external) and internal stakeholders excluding risk officers (senior management and first line of defense) were asked different questions. Here, risk officers include CRO, second and third lines of defense and external risk management consultants. The main findings of the online survey are summarized in this article.

1. Among all internal stakeholders, senior executives have the widest gap between the importance they ascribe to implementing ERM and their actual supportiveness.

2. In general, internal stakeholders excluding risk officers have a more optimistic view of ERM development in a company than risk officers.

3. Demonstrating and quantifying the value of ERM is the most difficult challenge faced by risk officers, as shown in Figure 1. Getting support from senior management is the least challenging one.

4. According to risk officers, relationship building, external stakeholder opinions and effective communication of difficult risk management concepts are the most used and most effective methods of ERM stakeholder engagement, as shown in Figure 2. Stakeholder analysis and embedding risk management goals into performance measurement are less used but more than modestly effective.

Figure 1
ERM Stakeholder Engagement Challenges

Figure 2
ERM Stakeholder Engagement Effectiveness

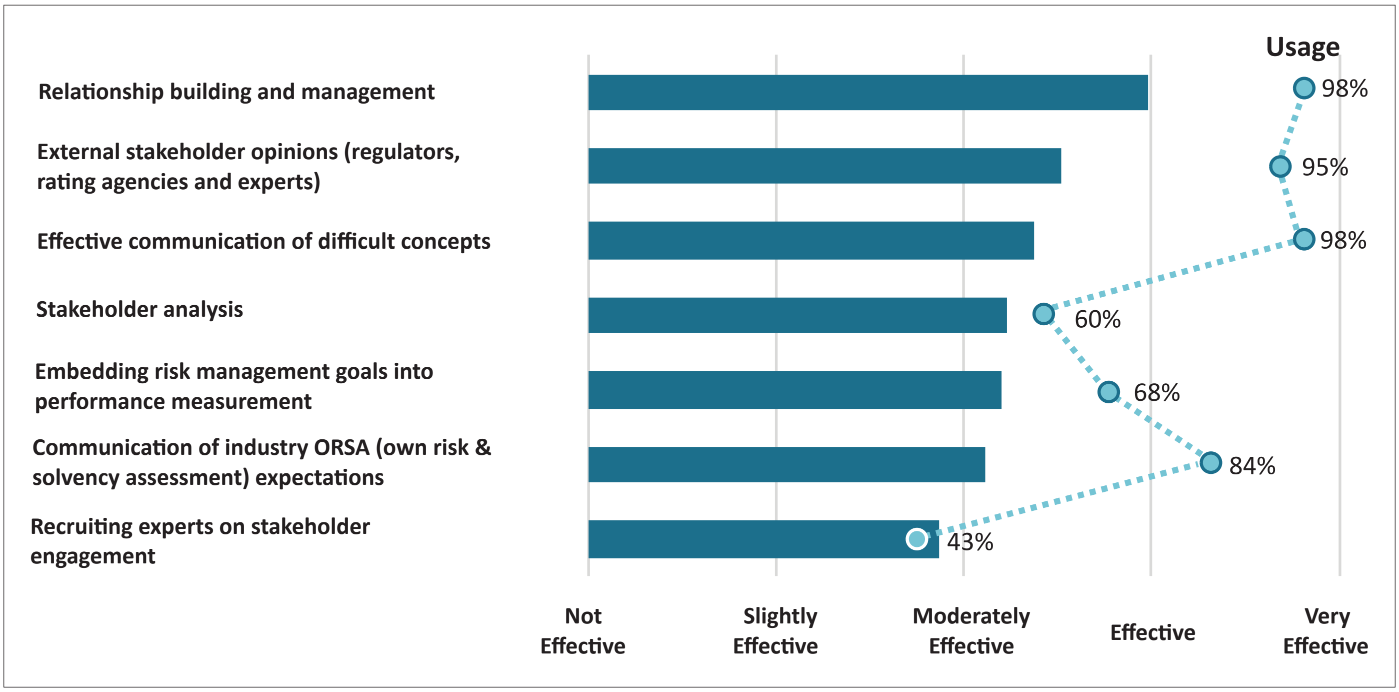
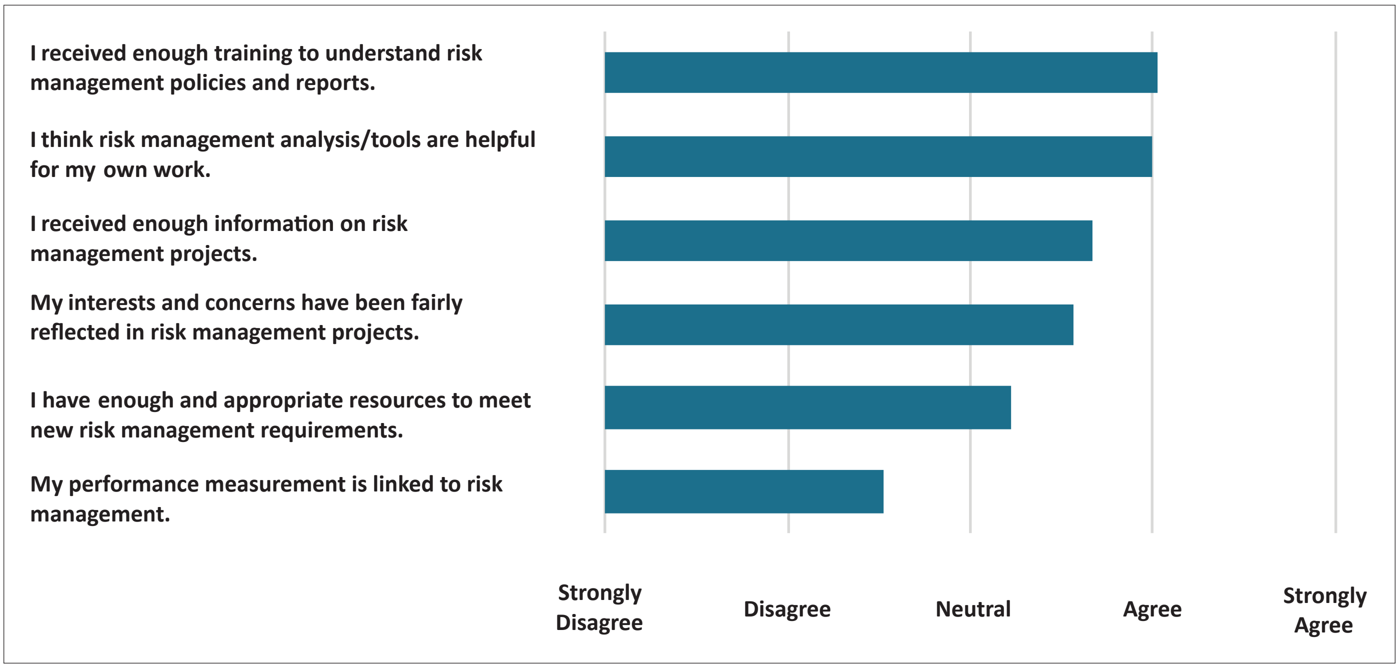


Figure 3
Internal Stakeholder Experience with ERM



5. Internal stakeholders excluding risk officers still face a lack of resources as a constraint to meeting new risk management requirements, as shown in Figure 3.

6. Face-to-face interviews are the most effective method of ERM communication, followed by regular reporting and workshops.

CHALLENGES

Major challenges are identified based on the survey responses.

1. **The benefit of risk management is difficult to measure**. Except when a risk management activity is driven by regulators or it helps improve the company's credit rating, the benefit of the project may not be apparent to some stakeholders. In normal periods, the cost of risk hedging or risk mitigation may be seen as a drag on profit. In an extreme situation, risk management may be blamed for losses even though the company was taking a risk exceeding its risk tolerance to stay competitive in the market.

2. **Risk management activities may also be affected by insufficient resources and internal politics**. Risk management teams may be understaffed. ERM initiatives may be deferred because of insufficient financial support. New ERM policies may change the status quo and encounter resistance in the company.

3. **Risk management could require material changes to existing practices and create additional work**. It takes time and effort for people to understand, test and agree on changes. It may also require additional tools and human resources which may not always be available.

4. **The role of the risk management function and the chief risk officer may not be clearly defined**. Risk management projects usually require involvement of many departments and it is not always clear who is accountable for the final result.

5. **Risk management concepts are rarely self-explanatory**. They discuss stress scenarios, extreme events and probabilities requiring statistical knowledge. It becomes even more difficult to explain advanced models used in economic scenario generation, nested stochastic calculation, tail risk management, risk aggregation and so on.

6. **The credibility of risk assessment results has room to improve**. Risk assessment deals with extreme events which may not be observed in recent history. Without validation, stakeholders may be inclined to make judgments in a heuristic way.

7. **Model risk is high for risk management analysis**. Risk management quantitative models are complicated, and the results are sensitive to assumptions. This sensitivity and complexity leads to high model risk which may hinder the contribution of risk management analysis to business decision-making.

8. **The value of risk management to improved decision-making may be overlooked**. Stakeholders may spend minimal time and resources to meet the requirements but not use the information and analysis to help make business decisions.

ENGAGEMENT STRATEGIES

To address the issues raised in the survey, several areas can be focused on to improve risk management stakeholder engagement. Figure 4 shows a standard stakeholder engagement process with suggested areas of improvement for each phase.

Figure 4
Stakeholder Engagement Process

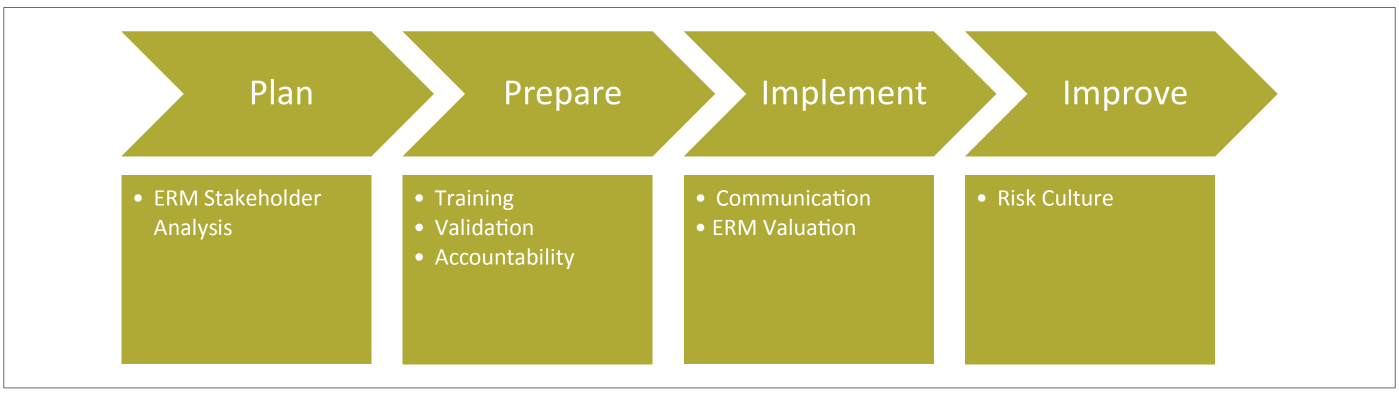
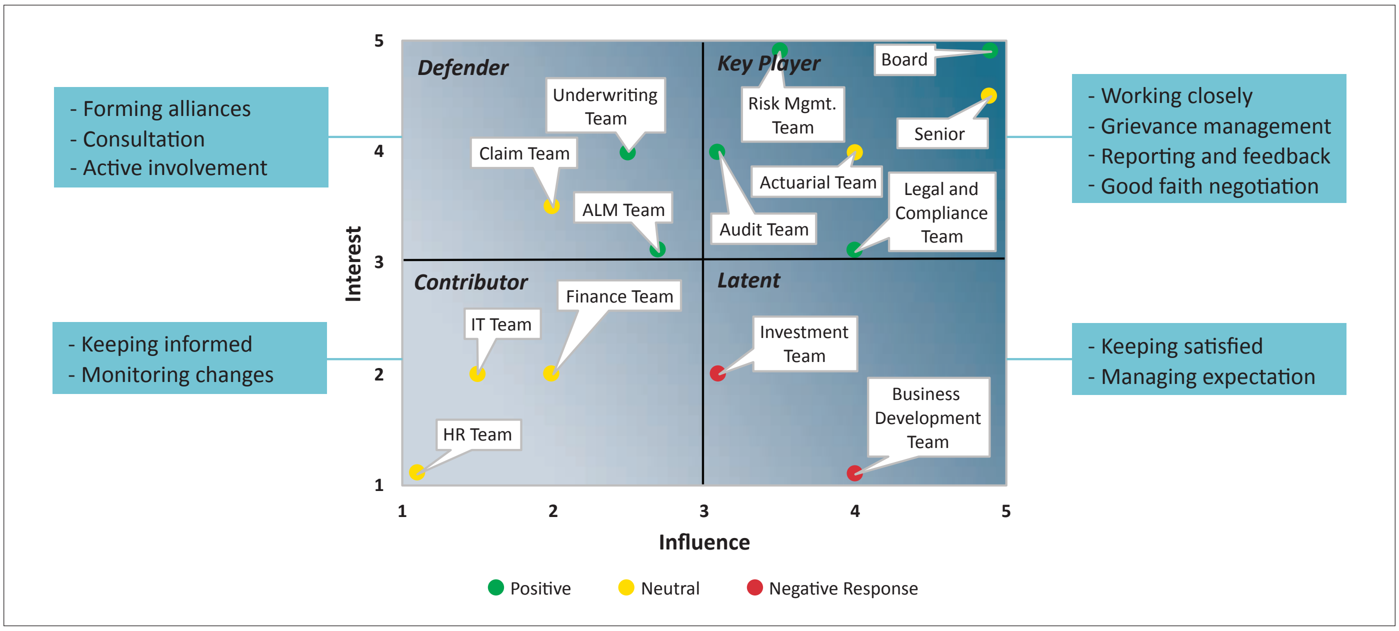


Figure 5
Sample Stakeholder Mapping



Stakeholder analysis helps predict stakeholders' responses and helps design appropriate strategies to improve stakeholder engagement. ERM stakeholder analysis can be conducted to identify stakeholders and analyze their interests, concerns, influence, and expected responses to an ERM initiative. Stakeholders can then be mapped into different engagement types with corresponding engagement strategies.

Figure 5 illustrates the mapping of internal stakeholders for an ERM initiative to bring risk adjusted measures into a business decision. Each stakeholder's interests, influence and responses are evaluated. A stakeholder has a high interest if he/she will be materially affected by ERM activities. A stakeholder has a high influence if he/she has a lot of power to change the course and outcome of ERM activities. The probable responses from stakeholders are jointly determined by their current level of interest, concern, and relevant knowledge and experience.

Stakeholders can be divided into four classes based on their interest and influence: key player, latent, defender, and contributor. Key players are stakeholders with both high interest and high influence. They need full engagement for the success of ERM activities. Defenders are usually helpful alliances to provide useful information and defend the risk team's positions in group decision-making. Latent stakeholders need to be adequately informed but not so much that they get overwhelmed. Contributors are the least affected by or involved by ERM activities but need to be kept informed to avoid any surprises. Different key engagement strategies are associated with different types, as shown in Figure 5.

Response, the third dimension, is reflected by the color of the dots representing the stakeholders in the circle in Figure 5. Stakeholders with negative response need more focus within each group.

Stakeholder mapping is not constant for all risk management initiatives. A stakeholder may belong to different types depending on the specific ERM activity. Changes in stakeholder mapping are also expected as stakeholders gain more knowledge and experience related to risk management. Therefore, it needs to be updated regularly.

Effective communication can help improve transparency, avoid misunderstandings and attract stakeholders. The importance of ERM needs to be communicated from the top. Risk communicators should know their audiences, use evidence-based communication as much as possible, embedding actionable suggestions into risk communication and maintaining a high standard of credibility.

More stringent regulatory requirements and many other risk management initiatives such as internal capital models, model risk management, and the integration of risk appetite and strategic planning are progressing well in the insurance industry. It requires a significant amount of extra effort to gain the knowledge and experience to make these changes. Usually, **training** focuses on the second line (risk management and compliance functions) and third line of defense (internal audit) in a company. The first line of defense (operational management) may have less training than it needs. Training is better designed according to people's roles and prior knowledge of the subject. In addition to project-based knowledge training, it is helpful to have a long-term training plan for all stakeholders.

Knowledge gap analysis can be used to design a personalized training plan for each stakeholder. Figure 6 illustrates a gap analysis for risk management knowledge. The knowledge of risk management is classified into three categories: risk management framework overview, impact on business/work and operational requirement. The black part of each circle represents the percentage of knowledge that an internal stakeholder holds for a risk management knowledge item. The goal is to fill the white part to remove knowledge gap.

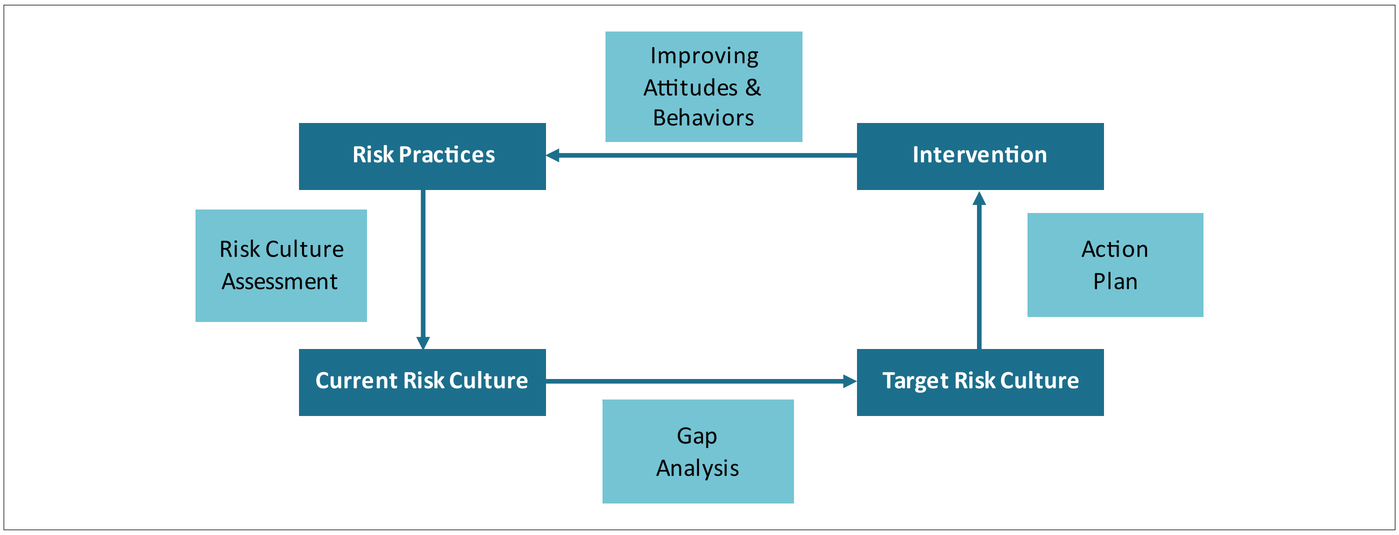
A company usually has multiple priorities competing for limited resources. The benefits of risk management are recognized in principle but may not be readily observed. This could put ERM priorities at a disadvantage in the competition for resources. **Evaluating ERM activities** is helpful for addressing this issue. Tangible benefits of an investment in risk management capabilities include lower cost of borrowing, risk mitigation benefit, capital efficiency, and better business decisions. They can be quantified and aligned with the organization's traditional project decision framework for project comparison and selection.

Validation is important to improve the credibility of ERM analysis. Stress testing and partial validation are beneficial in the presence of insufficient data. Stakeholders will have a higher confidence in using validated risk management analysis for decision-making. When communicating an assumed stress scenario with stakeholders, it is not necessary to assign a

Figure 6
Sample Risk Management Knowledge Gap Analysis

Knowledge/Skill		Board of Director	Senior Management Leader	1st Line of Defense			2nd Line of Defense			3rd Line of Defense		
				Leader	Middle Management	Other Staff	Leader	Middle Management	Other Staff	Leader	Middle Management	Other Staff
Overview	Risk Concept	●	◑	●	◕	●	●	◑	●	●	●	◔
	Risk Appetite	◑	◑	●	●	○	●	◑	◔	◕	●	○
	Risk Governance	◕	○	◑	◑	◕	●	●	◑	◕	●	◑
	Risk Control	◕	◕	○	◑	◕	◔	○	◔	○	◔	●
	Risk Culture	●	◕	●	●	○	◑	◑	●	●	◑	◔
Business	Risk Related Work	○	●	◔	●	◕	●	◑	○	◑	●	●
	Expected Engagement	◕	◑	◑	○	●	◕	●	●	◑	◕	●
	Decision-Making	●	◕	◔	◑	◕	◑	●	●	◑	◔	●
	Feedback	◑	●	●	◕	◑	○	◕	◔	◕	◑	◕
Operation	Risk Reporting	●	◑	◕	●	●	◕	●	◔	◕	◑	●
	Risk Limit	●	◔	◕	◔	●	◔	◔	●	◔	○	●
	Anti-Money Laundery	●	●	◑	◔	●	◕	◑	◑	◑	◑	●
	Cyber Security	○	◕	○	●	●	◔	◔	◕	●	○	●
	Privacy	●	◑	◕	○	◔	◑	●	◑	◑	●	●
	Social Media Policy	◔	◔	◑	◑	●	●	◕	●	●	◕	●
	Risk Issue Escalation	●	◔	◑	●	●	◕	◔	●	●	●	●

Figure 7
Risk Culture Improvement Process



probability to the scenario. An alternative approach is to put the scenario in the context of history by ranking it among historical extreme events. It is easier for stakeholders to understand the severity of a specific historical extreme event against which risk management aims to protect.

Accountability is important for making sure that risk policies and strategies are actively followed within the organization. Risk ownership, roles and responsibilities of the CRO, and risk management functions need to be clearly defined and communicated so that stakeholders know their goals and what to expect from a risk management project.

The long-term goal of a risk management system is to have a **healthy risk culture**. Risk culture reflects the attitudes and behaviors of a group of people regarding risk taking and risk management. Culture is the essence of a risk management system in that it defines what behaviors are encouraged or not. A good risk culture fosters the improvement of risk management from the inside of an organization. No matter how good risk management policies and models are, without a positive risk culture, their full value is unlikely to be realized.

Improving risk culture and ultimately ERM stakeholder engagement is a complicated and somewhat subjective process. As shown in Figure 7, risk practices need to be assessed to understand the current risk culture status. Gap analysis can then be performed against the target risk culture. Action plans can be made to improve the risk attitudes and behaviors in the organization.

Exact practices of assessment, gap analysis and intervention to improve risk culture depend on each company's specific situation and preference.

CONCLUSION

Risk management is a fast-growing area in the insurance industry. It has brought in new concepts, tools and methods of business decision-making. However, integrating risk management into business decision-making and corporate governance is still challenging. Ineffective ERM stakeholder engagement can be the result of inappropriate risk attitudes, lack of relevant knowledge and experience, insufficient resources, vague responsibilities, and unclear performance measurement.

ERM stakeholder engagement can be improved using strategies applied widely in project management and business operations. The uniqueness of risk management initiatives requires special considerations in stakeholder analysis, communication, training, valuation, result validation, accountability, and risk culture. With a systematic approach to improving ERM stakeholder engagement, the effectiveness and maturity of ERM can be enhanced and risk management can be more deeply embedded into business decision-making. ■

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