

HOW TO REVIEW AN ORSA

Co-Sponsoring Organizations:



Risk Culture Assessment Based on ORSA

By Kailan Shang

Risk culture is the key to the organic growth of risk awareness and risk management.

Importance

Risk culture reflects the attitudes and behaviors of a group of people regarding risk taking and risk management. It is the essence of a risk management system. No matter how good risk management rules and models are, without a good risk culture, they are difficult to create value for the company.

The importance of a healthy risk culture in effective risk management has been increasingly recognized. Toxic risk culture of some large global banks caused huge losses such as the London Whale and the Libor scandal in recent years. The Financial Stability Board issued a consultative document on the supervisory interaction with financial institutions on risk culture¹ in late 2013. It considers the failures to have a good risk culture as a root cause of financial crises, either systemic or idiosyncratic. In 2008, CEIOPS issued a consultation paper on ORSA² which states that a strong culture of risk management is the key underlying feature of the ORSA process. In the NAIC ORSA guidance manual³, risk culture that supports risk-based decisions is emphasized. In the IAIS Insurance Core Principle 16 on enterprise risk management⁴, it also talks about embedding risk culture in the company.

Rating agencies also consider risk culture as a key component of effective risk management. In the S&P's evaluation criteria for the ERM practices of insurance companies⁵, risk-management culture is the first of five areas to be assessed. Risk-management culture is the degree to which risk management is integrated with corporate decision-making. It can be considered as the risk culture at the top level of the organization.

A healthy risk culture can foster the improvement of risk management from the inside of an organization.

1. People monitor and manage risk actively and consistently.
2. More risks are likely to be identified.
3. Risk issues can be escalated quickly in the organization.
4. Decision makers can get risk information timely with high quality.
5. Risk adjusted metrics are used to measure the performance.

Challenges

When reviewing an ORSA, assessing the risk culture is a crucial but challenging task. ORSA reports may vary a lot from company to company and may not provide all information that is needed for risk culture assessment.

For large companies, especially global companies, there may be material differences in risk culture among business units or functions. Sometimes, a comprehensive assessment of risk culture needs to be done at a more granular level, for each business unit and function. However, ORSA reports may not give you that level of details.

ORSA reports may also focus on the target risk culture that is written in the risk policies but may not be achieved in reality. They may not tell the degree to which people in the organization embrace the risk management policies. It is also hard to know the details of risk management practices from the reports. Those are valuable information for understanding the gap between the target risk culture and the actual risk

¹ FSB, "Increasing the Intensity and Effectiveness of Supervision: Guidance on Supervisory Interaction with Financial Institutions on Risk Culture." (2013) http://www.financialstabilityboard.org/publications/c_131118.pdf

² CEIOPS, "Issues Paper: Own Risk and Solvency Assessment." (2008) http://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/IssuesPaperORSA.pdf

³ NAIC, "NAIC OWN RISK AND SOLVENCY ASSESSMENT (ORSA) GUIDANCE MANUAL." (2013) http://www.naic.org/documents/committees_e_orsa_wg_related_docs_guidance_manual_2013.pdf

⁴ IAIS, "Insurance Core Principle 16 Enterprise Risk Management." (2010) http://www.iaisweb.org/_temp/ICP_16_Enterprise_Risk_Management_standards_and_guidance_material.pdf

⁵ Standard & Poor's, "Evaluating the Enterprise Risk Management Practices of Insurance Companies." (2005)

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culture. It can be evaluated by interviewing with board members, senior management, risk professionals, and other employees.

Assessment

Ideally risk culture assessment is a part of ORSA. However, it is not specified in most regulatory requirements for ORSA. Even though reviewing an ORSA is not enough for a full assessment of risk culture, it can still give us some insights about it. Below is a list of questions that we may find answers from an ORSA report. They can be part of the criteria for risk culture assessment.

- Is there a clear and consistent statement of the company’s risk appetite and risk tolerance?
- Do risk committees include key stakeholders who are the final decision makers?
- When setting business strategies, do senior risk managers provide inputs and have a big influence on decision-making?
- Are risk adjusted measures used for making business decisions?
- Are risk adjusted measures used for evaluating the performance of senior management?

- Are there enough risk professionals in the company?
- Are there enough communication and training about risk management in the company?
- Are newly identified risk issues escalated to senior management quickly?
- Is whistle blowing encouraged and appropriately rewarded?
- Are employees encouraged to recognize their biases and correct them?

After gathering information, risk culture needs to be rated. As most of the assessment is qualitative, it is difficult to build a scoring system with many levels. Simple scoring systems are recommended to use. For example, risk culture can be rated as weak, standard, or advanced, with an increasing level of healthiness.

Weak: People passively follow risk policies and rules set up in the organization.

Standard: People understand the importance and value of risk management and are encouraged to help improve risk management practices in the organization.

Risk Culture Evaluation Criteria: An Example	Weak	Standard	Advanced
The company has a clear and consistent risk appetite statement.	Maybe	Yes	Yes
Risk committees include final decision makers.	Maybe	Yes	Yes
Senior risk managers have a strong influence on strategic planning.	No	Maybe	Yes
Risk adjusted measures are used for informed decision-making.	Maybe	Yes	Yes
Risk adjusted measures are used for performance measurement.	No	Maybe	Yes
Enough qualified risk professionals are hired.	No	Yes	Yes
Enough communication and training on risk management.	No	Maybe	Yes
Formal and effective risk issue escalation policy and process.	Maybe	Yes	Yes
Whistle blowing is encouraged and rewarded.	Maybe	Yes	Yes
Employees are encouraged to recognize their biases and make correction.	No	Maybe	Yes

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Advanced: People actively participate in all aspects of risk management and cooperate to get to the company's target risk profile.

Risk culture can be rated based on criteria like below.

Here it is assumed that the only source of information is ORSA reports. If other information is available through interviews with senior management for example, the list of criteria can certainly be expanded.

Conclusion

Risk culture is a key element of effective risk management. An ORSA may not assess risk culture separately but contains some key information that can be used for a high level assessment. The best practice is to integrate risk culture assessment with ORSA.



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