Insights

March, 2014

The role of the Chief Risk Officer in the spotlight

A strategic thinker and catalyst of change

The role of the Chief Risk Officer (CRO) is becoming increasingly important within the insurance sector. The financial crisis in 2008 and the subsequent economic turmoil have put risk management at the top of the corporate agenda. Reviews of corporate governance[1] and the imminent introduction of the Solvency II regime have driven changes in the European insurance sector. The CRO is now typically a key member of European insurers' leadership teams. In our latest ERM survey[2], most companies (84%) have appointed or intend to appoint a CRO or equivalent.

Nevertheless, the role of the CRO is still in its relative infancy and in many cases is still evolving. In our experience, many insurance company Boards continue to debate the real focus and purpose of the CRO in the company. Views amongst CROs are also mixed about their satisfaction with their roles; some are finding their roles stimulating and rewarding, whilst others appear to be finding it difficult to see how their role is adding value.

To gain a deeper insight into CROs' views on their roles, Towers Watson recently carried out interviews with a number of CROs from various insurance companies across Europe. The objective of these interviews was to gain additional information on the focus of their role; their opinion on the changing nature of the role and the challenges ahead.

This article sets out the key themes and findings from our interviews and discussions, together with our own views of the skill sets required by CROs. We would like to thank all the CROs we have spoken to for taking the time to kindly provide us with their candid opinions.

Key observations

The CROs we interviewed admitted that their role is challenging and demanding, and in some cases the exact nature and scope of the position is not clearly defined. They had a range of backgrounds including qualified actuaries, accountants, engineers and experienced business directors.

The majority of CROs agreed that having only exceptional analytical skills is not sufficient. The most successful CROs are able to combine these skills with highly developed commercial, strategic, leadership and communication skills to be able to drive change and make a difference in an organisation.

Accordingly, we have observed a trend of appointing successful business leaders to a CRO position. This demonstrates the growing importance associated with this role in the insurance market.

A true business partner

During our interviews, a common topic of discussion was the effectiveness of the CRO and CEO/CFO relationship. The views were mixed and the effectiveness of this relationship was described as ranging from 'highly effective' to 'potentially destructive'. However, it became clear that the strength, quality and balance of this relationship significantly influences a CRO's personal satisfaction with the role as well as being a key driver of its success. In the cases where this relationship worked well, CROs appeared to be satisfied and stimulated by their roles. They saw themselves as valued contributors to the company's day-to-day decision making, supporting the business in its strategic

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1 The Walker Report, Review of Corporate Governance in UK banks and other financial industry entities, September 2009
2 Seventh Biennial Global Enterprise Risk Management Survey, Towers Watson, November 2012

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development and being fully supported by the Board. On the contrary, when the CRO role was not given adequate focus and importance in the organisation, the collaboration needed from the business units, as first line of defence, was difficult and it was challenging to move from an assurance focus to value generation.

But what is the ideal operating model? According to our latest ERM survey, CROs now report directly to the CEO in 53% of cases. This is an indication of the growing importance of the CRO role in the industry. We believe that for this role to be truly effective in assisting the business to generate value, the CRO needs to be an equal player amongst the C-suite: participating actively at core decision-making forums, challenging the first line of defence and introducing healthy and creative tension. For example, CRO's attendance at key strategic meetings is vital to ensure an adequate risk view on business decisions and to contribute to the CRO's job satisfaction. This could aid to reduce the observed high turnover of CROs in the industry. We believe that in order to generate value, CROs should act as a true business partner and constructive business challenger.

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Some interviewees were of the opinion that a CRO is a 'risk-focused CEO': An individual who considers the same strategic issues as the CEO but provides a unique risk perspective and analysis. For example, consider an insurer evaluating the strategic benefits of entering a new line of business. The CEO is likely to focus more on the potential for value creation of this option. He or she would be appraising areas such as potential increase in revenue, increase in customer base and building the brand. The CRO's primary responsibility will be to evaluate the new risks and exposures (for example, operational risk resulted from limited expertise); and how these could be mitigated and managed. In our opinion, the different perspectives are not opposed but complementary; and ensure a more balanced decision-making process. See **Figure 01**.

Insurance companies are in the business of managing risk and increasingly being urged to prioritise risk management and innovation in order to grow their businesses. We believe CROs can play an important role in supporting the leadership team in achieving these objectives. Often, risk management is associated purely with the avoidance of large losses but it can add real value in helping to identify growth opportunities where the risk and reward relationship is well managed.

Figure 01. Complementary perspectives to enhance decision-making process

The support of the Board and the CEO cannot be underestimated. The tone must be set from the top. The leadership team must believe in the benefits of risk management practices, communicating this message across the business and demonstrating this belief through their actions.

As well as the relationship with the CEO, there are a number of other key relationships which the CRO must manage and nurture. These include the Non-Executive Directors, CFO, Chief Actuary, Chief Investment Officer and business units. As one CRO said, they need to 'win hearts and minds' in the organisation. Well-developed soft skills such as persuasion and communication are critical; the CRO must act as the driving force in the creation and development of a positive risk culture within the firm. In addition, the use of informal channels of communication should not be underestimated.

Don't let regulation rule

There was a strong belief amongst the CROs we interviewed that the role of the CRO in an organisation should be driven by business needs, not regulatory requirements.

Regulatory regimes like Solvency II appear to be driving insurance companies across Europe to place excessive emphasis on the compliance aspects of the CRO role as a pure 'second line' role rather than in its potential to generate value.

In accordance with article 44 of the Solvency II Directive, insurance companies require a 'risk management function' to report to the Board on the risks they are facing or could face in the future. Some European regulators, however, are more explicit in their requirements. For example, in the UK, the PRA (Prudential Regulatory Authority) in its Handbook – Senior Management Arrangements, Systems and Controls (SYSC), article 21.1.2 – describes the role of the CRO in some detail. See **Figure A**. Similarly, the Federal Financial Supervisory Authority (BaFin) in Germany, in its Minimum Requirements for Risk Management for Banks and Financial Services Institutions (MaFin), provides its expectations regarding the Risk control function. See **Figure B**.

Figure A. Role of the Chief Risk Officer

Prudential Regulatory Authority (PRA), UK – Handbook – Senior Management Arrangements, Systems and Control, SYSC 21.1.2

	Chief Risk Officer should:
✓	be accountable to the firm's governing body for oversight of firm-wide risk management
✓	be fully independent of a firm's individual business units
✓	have sufficient authority, stature and resources for the effective execution of their responsibilities
✓	have unfettered access to any parts of the firm's business capable of having an impact on the firm's risk profile
✓	ensure that the data used by the firm to assess its risks are fit for purpose in terms of quality, quantity and breadth
✓	provide oversight and challenge of the firm's systems and controls in respect of risk management
✓	ensure the adequacy of risk information, risk analysis and risk training provided to members of the firm's governing body
✓	report to the firm's governing body on the firm's risk exposures relative to its risk appetite and tolerance, and the extent to which the risks inherent in any proposed business strategy and plans are consistent with the governing body's risk appetite and tolerance
✓	alert the firm's governing body to and provide challenge on, any business strategy or plans that exceed the firm's risk appetite and tolerance; and
✓	provide risk-focused advice and information into the setting and individual application of the firm's remuneration policy

Figure B. Role of the Chief Risk Officer

Federal Financial Supervisory Authority (BaFin), Germany, Minimum Requirements for Risk Management for Banks and Financial Services Institutions (MaFin)

	Risk control function
✓	The head of the risk control function must occupy as high a position in the hierarchy as possible – in the case of major international institutions this must expressly be at executive level. This ensures that risk issues are given high priority, addressed early and approached with emphasis.
✓	In accordance with the planned CRD (Capital Requirements Directive) and EBA (European Banking Authority) guidelines, the head of the risk control function should perform his or her duties exclusively. However, depending on its size and the nature, scope, complexity and risk content of its business activities, the institution may make deviations to ensure adherence to the principle of proportionality.
✓	Combining the risk control area with finance/accounting (chief financial officer) into one executive responsibility is thus no longer possible for large, internationally active institutions.
✓	Regarding further duties that cannot be assigned to the market or trading areas, BaFin will examine in each individual case the extent to which they align with the core responsibility of risk control, independent monitoring and communication of risks at the institution and can thus be permitted to be.

One of the challenges CROs face is that regulation could become a significant barrier to expand their role in the business. The CRO as second line of defence must maintain independence. This is an important aspect for insurers to be able to demonstrate. However, oversight structures tend to separate risk supervision and day-to-day risk management, creating a difference between first and second line activities. We believe that for the risk function to support the company in generating value, an effective partnership relationship between first and second line of defence must be developed; integrating risk management into the normal management activities of the first line.

“We consider a sign of maturity of the role to be when it focuses on value creation and not only on reducing the risk of value destruction.”

We have found there is a strong tendency to apply a compliance led approach to the risk function. In many instances the CRO’s position was created because of regulatory and other external drivers rather than value considerations. This has resulted, in some cases, in an excessive focus on strict rules and rigid governance structures driven also by Solvency II high documentation requirements. This approach makes it difficult for a CRO to be perceived as a ‘trusted business partner’. We consider a sign of maturity of the role to be when it focuses on value creation and not only on reducing the risk of value destruction.

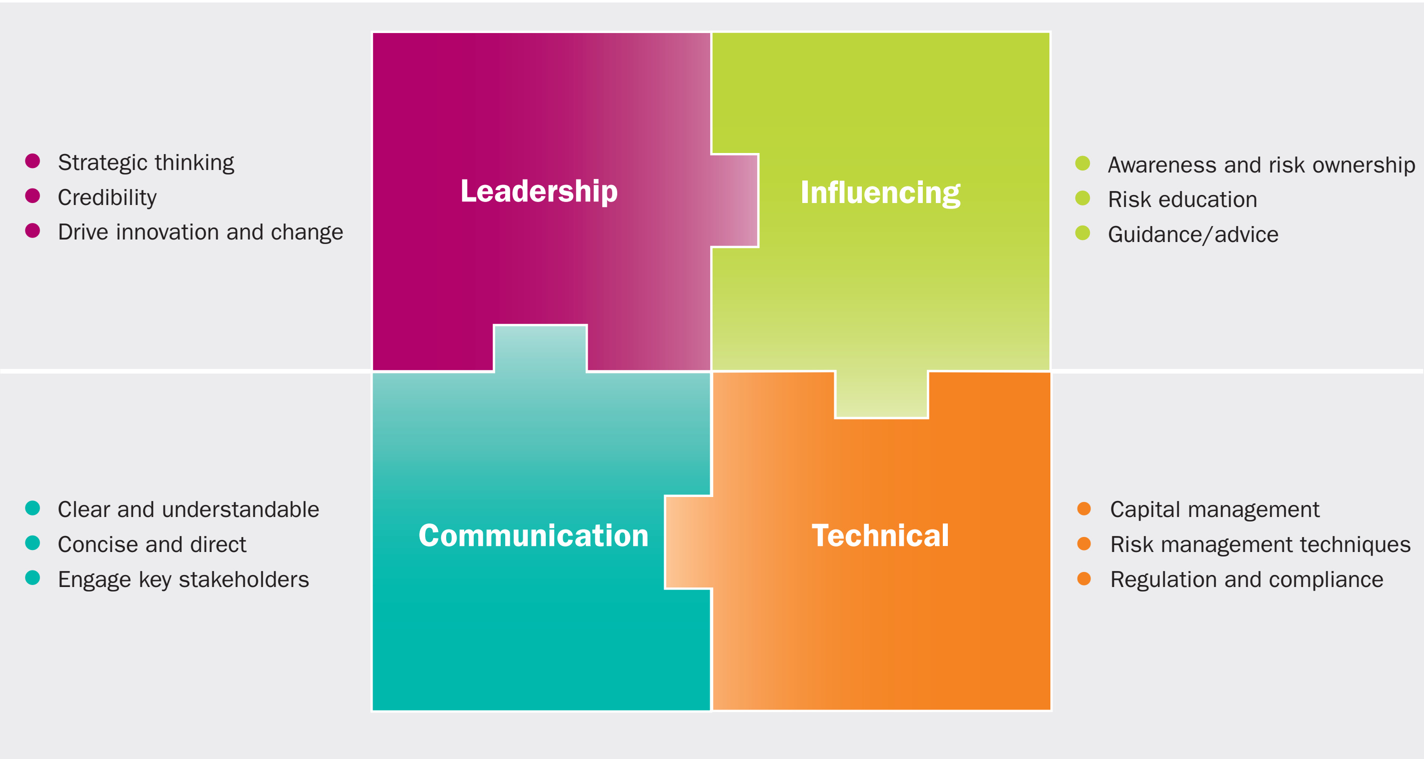
CROs will only be able to deliver more insight and identify business opportunities if risk management is viewed by senior management as an enabler to improve business performance. But this is a cultural shift that will need to take place in most insurance companies. Business units need to see the CRO as an ally, rather than a ‘pessimistic risk controller’.

Piecing together the CRO jigsaw

It is clear from the interviews conducted with CROs that, as an industry, the insurance sector is a long way from a common view of the CRO role.

But taking account of the interviews and our experience in the market, we believe there are four key skills that are emerging for a successful CRO to display. These are outlined in **Figure 02**:

Figure 02. Chief Risk Officer’s key skills



- **Leadership**: A CRO must be able to apply risk insights to meet business goals and objectives. An effective CRO is a strategic thinker and a catalyst of change: continuously driving innovation and change, looking for opportunities to achieve a profitable balance between risk and reward, promoting a positive risk culture; and improving risk management capabilities. As the risk function leader, the CRO will need to drive and coordinate various risk management teams in the implementation of a risk management framework. This will involve ensuring that these teams have sufficient skills, knowledge and experience to be efficient and effective. Also, it is important that the CRO has credibility within the organisation and is viewed as a key player in the leadership team. He or she must have a clear vision of how to deliver value to stakeholders, and should be able to identify opportunities as well as potential risks of losses.
- **Influencing**: The CRO is not the owner of specific risks; he or she has the responsibility for the oversight of the entire risk framework and has to ensure that for every risk there is always somebody in charge. It is critical therefore, that the CRO can persuade front-line management and risk owners to participate actively in the measurement, control and mitigation of risks. This involves educating the business on the benefits of risk management; ensuring buy-in from the Board and the rest of the organisation. For this to happen, the CRO must be seen as the key point of contact for those performing front line activities. He or she must gain the business leads trust by delivering timely and expert advice but also providing guidance on risk issues and advising on risks related to new initiatives and major strategic decisions.
- **Communication**: CROs need outstanding communication skills to be able to convey complex risk information to the Board, senior management and key external stakeholders in a clear, concise and understandable manner. The quality and timeliness of this information is also important. A successful CRO must be able to communicate at all levels in the organisation; using business language to engage with key stakeholders, so he or she can be trusted as a valued advisor who can help them to understand and manage risks better and promote a positive risk culture throughout the organisation.
- **Technical**: A good understanding of capital management, allocation concepts and methodology; as well as risk management techniques from risk identification, evaluation, managing and monitoring. He or she must be able to understand the implications of changes in the company's risk profile. The CRO is responsible for creating a risk framework to assist the organisation to manage and mitigate risks effectively. They should also have a clear understanding of regulatory and compliance issues and policies to ensure the company meets the expectations of regulators, credit rating agencies and investors.

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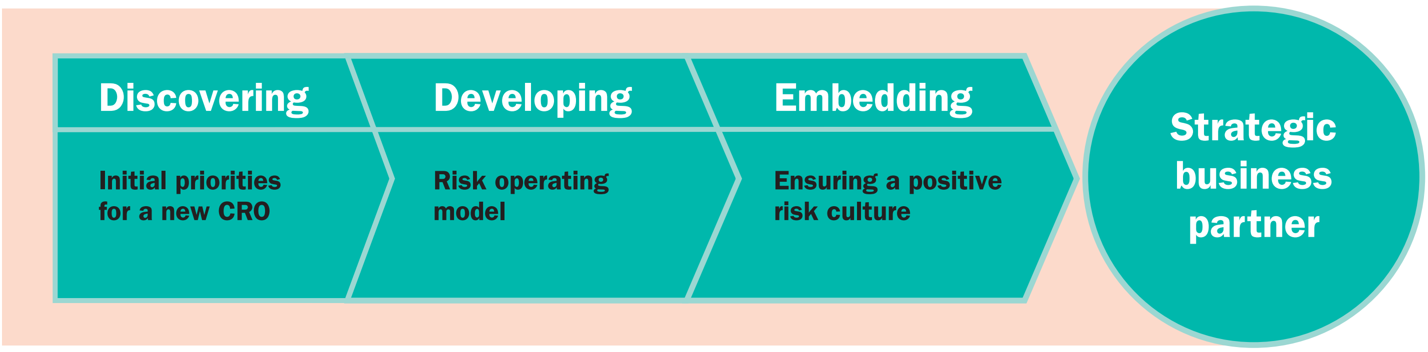
The CRO journey

Equally, the focus and priorities of a CRO change over time (see **Figure 03**). In our experience, a new CRO is likely to follow the following path:

- **Discovering**: this involves understanding the mission and key objectives of the business in order to develop a risk strategy, risk appetite and metrics aligned with the business strategic plans.
- **Developing**: this involves the design and implementation of a risk operating model that sets the basis for the way in which the risk function will operate. This will include the development of an organisational structure with clear lines of roles and responsibilities; policies and terms of reference; processes and procedures; management information and reporting; and a performance management system that rewards the right risk management behaviours. See case study 01 for an example of how we supported a client refining their risk operating model.
- **Embedding**: ensuring a positive risk culture by embedding risk practices in the company's day-to-day management; using levers such as communication, training and governance to promote a consistent understanding of risk; and assisting in an effective integration of the three lines of defence. The real value comes from the impact CROs will have on the whole business, promoting a different way of thinking about risks and dealing with them. See case study 02 where we supported a large multinational insurer in measuring and monitoring its risk culture.
- Strategic business partner: It is at this stage where the role of the CRO can become truly strategically focused, actively participating in key decision-making processes and generating value from identifying profitable opportunities and managing effectively the associated risks. The CRO will also need to maintain the developed risk framework to ensure it remains fit for purpose; identifying additional training and education needs; keep abreast with evolving risk management best practices; and maintain a close relationship with regulators, rating agencies and investors to ensure their expectations are met.

> "The real value comes from the impact CROs will have on the whole business, promoting a different way of thinking about risks and dealing with them"

Figure 03. The Chief Risk Officer journey



- End-state vision
- Risk strategy
- Risk appetite and limits

- Roles and responsibilities
- Governance
- Processes and documentation

- Risk ownership
- Integrated lines of defense
- Communication/co-ordination

- Strategic decision-making
- Relationships with external stakeholders
- Monitoring and on-going improvement

Conclusions

In this article we have presented the results of our interviews with European CROs. These interviews have shed light on the challenges of this evolving and increasingly important role.

Key messages drawn are the following:

- The CRO role requires a skills base broader than that of an experienced technician and broader than that of a business manager. A balance must be struck between technical expertise and 'softer' skills.
- The nature of the relationships between the CRO and CEO and between the CRO and the Board appeared to be a key determinant in the success of the CRO role.
- Regulation should not dictate the profile of the CRO role; the role must be tailored to meet business expectations.
- The role of a CRO is fluid and evolves over time with the organisation. Once a new CRO has moved through the initial stages of discovering, developing and embedding risk management, the CRO role is about maintaining the risk framework and focusing on supporting the business in creating value from thinking and acting upon risks differently.

Case study 1: Refinement of a risk operating model

Towers Watson was asked to support the delivery of the Risk Function plan with the view to meet the Internal Model Approval Process (IMAP) submission deadlines. Our client's Risk Function was under-resourced and they appointed a team of Towers Watson risk management consultants to provide interim resource whilst recruitment was on-going.

Our support focussed on the refinement of the risk operating model, working closely with the Head of Risk, Actuarial Function and Audit Function.

Key activities included the review and rationalisation of risk management policies, focusing on providing the framework to support the business as well as meeting regulatory requirements; we supported them drafting key policies and processes focusing on Internal Model Validation. We also assisted in the development of a risk register to document all key risks and how these risks will be evaluated, measured, mitigated, managed and reported.

Our collaborative approach ensured business buy-in of the new risk management practices and promoted risk ownership throughout the company.

Case study 2: Risk culture

A large multinational insurance business with a substantial global presence recognised the need to develop its approach to risk management. The senior leadership team wished to have an effective way of understanding and reporting on the risk culture of the company, both to support internal management and oversight, and to be able to report externally. It was decided to design and implement a risk culture survey to provide a 'current state' measure and to inform and evaluate future changes in culture.

Towers Watson partnered with the company's Group CRO and conducted a series of interviews with stakeholders in all areas of the business. An approach and questionnaire were developed to measure the aspects of risk culture most pertinent to the company's strategy and current context. Senior management, risk professionals and related risk units, and key risk takers in the business were of most interest. The survey was launched and hosted online, with strong participation from the different business units and geographic areas.

A comparison of findings to external benchmarks showed a good deal of confidence in key aspects of the risk culture such as the clarity of strategy, willingness to speak up and organisational learning from mistakes. The findings also highlighted potential areas of improvement in governance, information and reporting. Recommendations were well received and plans were put in place to make the necessary improvements. We are currently engaged on a follow-up survey to support the client in assessing progress towards its end-state risk culture.

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