

# Building a strong insurance risk culture

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## Highlights

- Organizations with mature risk cultures are more likely to make decisions that satisfy long-term business goals and meet regulatory demands.
- Although a risk culture starts at the top, with strong messages and consistent behavior from leaders, all employees should see themselves as risk managers and consider the risks in their everyday decision-making.
- Incentives and performance management have a big part to play in rewarding appropriate risk behavior; there should be zero tolerance for inappropriate risk-taking.

**M**ore than 7 years after the onset of the global crisis, the financial sector continues to attract unwanted headlines, with the spotlight shifting somewhat from banks to insurers. Consequently, regulators are taking a heightened interest in organizations' risk management and underlying cultures. In 2014, the International Association of Insurance Supervisors (IAIS) called for insurers to demonstrate "the ability to promote a sound risk and compliance culture across the group."<sup>1</sup>

The Financial Stability Board (FSB), an international body that monitors and makes recommendations about the global financial system, has also issued guidance on risk culture stating that: "supervisors should satisfy themselves that risk cultures are based on sound, articulated values and are carefully managed by the leadership of the financial institution," and furthermore that: "institutions with a strong culture of risk management and ethical business practices are less likely to experience damaging risk events and are better placed to deal with those events that do occur."<sup>2</sup>



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<sup>1</sup> *Issues Paper: Approaches to Group Corporate Governance; Impact on Control Functions*, International Association of Insurance Supervisors, October 2014.

<sup>2</sup> *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture*, Financial Stability Board, April 2014.

“Traditionally, ‘risk’ within insurance is seen as solely the domain of the actuary. This is no longer the case.”

### In a strong risk culture...

- the board and executive management drive risk culture
- every employee understands and embraces the organization’s risk appetite and risk management framework
- threats or concerns are identified and escalated swiftly, with employees comfortable (and encouraged) to raise issues
- individuals are clear about the risks inherent in their strategic and day-to-day decisions
- every employee continuously learns from the experiences of others
- personal and organizational interests are aligned, via appropriate performance metrics, linked to remuneration risk behavior is monitored regularly, with swift corrective actions taken over any breaches; staff are encouraged to consult with their superior when they are uncertain whether a particular action is outside the organization’s risk tolerance.

### Why risk culture matters

Risk culture can be described as the way in which decision-makers at all levels within an insurer consider and take risks. When risk appetite is fully agreed and understood, all employees are conscious of risk in their everyday decision-making, appreciate the trade-offs between risk and reward, and consider the interests of the wider organization above their individual objectives.

However, defining risk culture, and establishing a sound risk management framework, is a considerable challenge. Traditionally, ‘risk’ within insurance is seen as solely the domain of the actuary, and employees in customer-facing or product design positions may have never even acknowledged that there is a risk management element to their work. Consequently, many organizations fail to prevent excessive or inappropriate risk-taking, which can, in some cases, cause significant losses, penalties and negative publicity. One example is the recent UK payment protection scandal, where insurance companies and bancassurers are having to pay billions in compensation for mis-selling of policies.

In organizations with weak or undeveloped risk cultures, responsibility for risk management is unclear, with lack of board oversight and direction, low awareness of risks amongst employees, and deficiencies in risk monitoring, reporting and controls. The risk management function itself is typically under-resourced and under-qualified, while key individuals such as the Chief Risk Officer (CRO), the Chief Financial Officer (CFO) and the approved actuary often have multiple risk decision-making roles that create an excessive workload.

Perhaps more importantly, individuals are not measured or incentivized on risk performance, and there is an over-tolerant attitude to breaches or mistakes, with those taking excessive or inappropriate risks rarely disciplined, implying that such behavior is acceptable.

Within a branch network or telephone service center, staff may be under

considerable pressure to meet targets, which can lead to sales of products that are not always a) in the customers’ best interests and b) in line with strategic goals. Incentive schemes are partly to blame, by rewarding salespeople primarily for goals set by their immediate managers, which may prioritize volume over quality. These can apply both to direct sales and those made through intermediaries.

Insurance companies’ reputations are also at daily risk from poor service quality resulting from slow, inaccurate or unfair claims handling, or marketing messages that over-promise benefits (such as speed of replacement for stolen or damaged goods, or availability of hire cars to replace damaged vehicles). A poorly designed online sales process can easily cause customers to self-select the wrong products.

Compliance reporting, for regulations including Solvency II and International Financial Reporting Standards (IFRS), can also highlight weaknesses in risk management. Insurers may be unable to demonstrate that controls are in place, and being adhered to, and fail to produce accurate reporting that paints a true picture of the business.

Consequently, regulators are raising the bar by demanding more risk-sensitive capital regimes, as well as stress and scenario requirements. They are also, increasingly, requiring a clearly articulated risk appetite statement, better assessments of risk management frameworks and risk culture, and expecting senior executives to be rewarded directly for encouraging sensible risk-taking behavior that supports long-term corporate financial interests.

### From awareness to action

Ultimately, culture is all about actions; not policies or documentation. With regulators showing an increasing interest in risk culture and behavior, how can companies take a barometer of their current capabilities, in order to make relevant improvements?

There are three important questions to address:

- Does the organization have appropriate structures and processes in place to define the desired culture?
- Are those structures and processes adequate to create the desired culture?
- Do structures and processes drive effective behaviors in practice?

An in-depth evaluation involves close scrutiny of risk and compliance policies and past interactions with regulators, along with detailed observations of staff behavior at all levels. By seeking the views of a cross-section of employees and managers, leaders can better understand employees' attitudes to risk management, and how risk management policies, procedures and systems work in practice, highlighting any gaps.

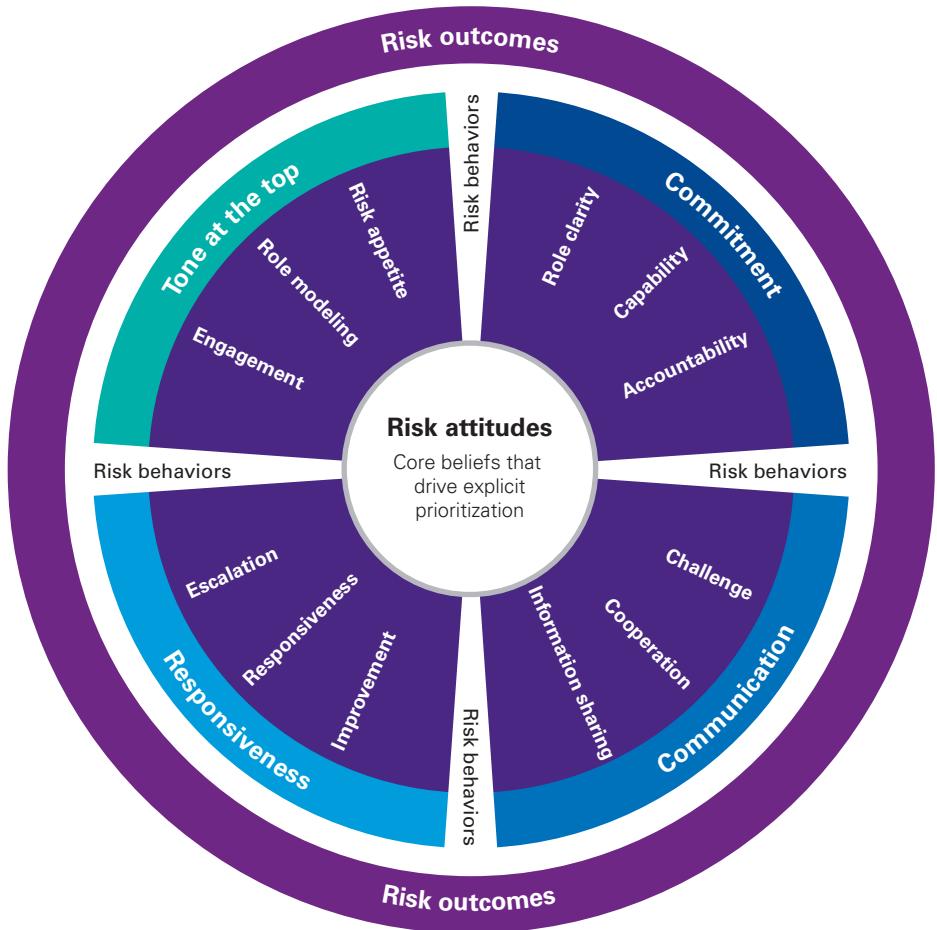
Data analysis can reveal patterns of customer complaints, regulatory fines and requests for closer supervision and monitoring, across different departments and locations. Such incidents should be monitored constantly, and their root causes identified, to offer a continuous indicator of cultural performance. This is a sizeable investment requiring strong endorsement from leaders.

Insurance companies with strong risk cultures are likely to exhibit four key characteristics:

### 1. Tone at the top

The board and executive management should drive risk culture, with leaders exhibiting total consistency in words and actions, taking a visible lead in risk management activities — and being fully accountable when risk parameters are breached. By making risk a formal standing agenda item at board and management forums, they can demonstrate its importance to all stakeholders. They must ensure that all employees are aware of the organization's approach to risk management, reward positive behavior and act decisively when inappropriate risks are taken, if necessary through disciplinary action. It is very helpful to keep in touch with front-line activity through regular visits to branches and contact centers.

### Key risk attitudes



Source: KPMG International, 2015.

### 2. Communication

Although leaders set the tone, they can't be alone in delivering messages about the importance of risk. Senior managers of divisions and business units are also part of the communication process, which must filter down through the organization — and between departments — to the most junior people. In this way, everyone can understand the risk appetite and capacity at the individual, team, department and company level. In addition to recording sales calls, staff should engage in focus groups,

surveys and one-on-one interviews, to ensure they are continually aware of the risk culture and are conforming to procedures.

Rather than acting as static recipients of advice, all employees should be encouraged to actively share information and feel safe to challenge unacceptable behavior and escalate issues. This calls for clear channels for 'whistle-blowing', implying that it is acceptable to criticize the business's activities without fear of retribution.

### Creating an effective transformation program

The program should aim to build a culture aligned with strategy, values and risk appetite. It needs to detail actions to address any gaps in current risk management practices; actions that are specific, owned by an accountable executive, subject to time limits and have relevant success indicators. Regular reviews can keep the program on track and evaluate progress against milestones.

### Questions for insurers

- Is the board able to articulate the kind of risk culture it wants, and can it explain this clearly to all employees?
- Does the board have a road map towards a strong risk culture, and can it demonstrate steps it is taking in this direction?
- Are risks being identified, measured, managed and controlled in a manner consistent with the organization's risk appetite?
- Do all staff understand and adhere to the organization's risk appetite, as it relates to their particular roles?
- Do employee incentives promote long-term financial sustainability?
- Do all employees at all levels have the skills to manage risk effectively?

### 3. Responsiveness

In a risk-aware culture, issues are escalated and dealt with swiftly and decisively, before they can become major problems, with a central point of contact for all employees for the management and treatment of risks. And, crucially, any learning from such incidents is assessed and built into future policies and behavior, to avoid a reoccurrence. If something slips through the cracks, management should analyze why staff did not comply with protocols, and re-educate people on the importance of such checks and balances, as well as stressing the need to act within the 'spirit' of risk management.

### 4. Commitment

Risk must become second nature to all, and not something that applies only to actuaries and/or a central risk team. High profile cultural transformation programs often fail to achieve lasting change, because they don't focus sufficiently upon individuals, nor explain how people should behave to be more risk-aware. To make cultural change happen, leaders must understand the day-to-day dilemmas faced by staff — such as management pressure on sales numbers — and address these issues directly. Performance management and related compensation systems are key to gaining commitment and should balance local branch/office sales targets with wider organizational goals, as well as rewarding good risk management behavior, which will deter staff from taking unnecessary risks in pursuit of short-term profit. Whether selling in person, by phone or online, direct or through intermediaries, the same principles of fairness and appropriateness must apply.

The approval process for new marketing initiatives has to be robust, to ensure that the business has the capability to meet any promises. Risk management also requires new skills, in order to identify, assess and mitigate risks, which calls for tailored training and coaching.

### Good for compliance, good for the business

As well as increasing the chances of remaining compliant, a strong risk culture gives the board and shareholders greater confidence in an insurer's integrity and in its ability to meet customer expectations. Comparison websites may have made the sector more price-driven, but customers still appreciate doing business with companies that are seen to be acting in their interests, through offering relevant products, attentive customer service and a swift, fair claims process.

Having invested in risk processes and frameworks, insurance companies must also devote resources to building a risk culture, to bringing frameworks to life and to ensure adherence to policies. Once this has been achieved, all employees — not just actuaries — will be able to say that they are risk managers. ■

Parts of this article were taken from a chapter, *The rising importance of risk culture, in the KPMG publication: Evolving Insurance Regulation, The journey begins, Part 1*, May 2015.

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Rob joined KPMG Australia on 1 April 2014 to lead the ASPAC Insurance Risk and Regulatory practice and continues to be KPMG's Global Regulatory Lead for Insurance. Rob has significant experience in regulation having developed the UK ICAS regime and leading the FSA's Solvency II program. In addition, Rob has successfully led risk and capital transformation projects at the largest UK Life and Non-Life firms respectively. Rob leads KPMG's global response for insurance on systemic risk issues.

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Andrea leads the People and Change capability for the insurance sector in KPMG's UK member firm. She is highly experienced in leading change management, HR and organization design workstreams for complex transformation programs, helping clients navigate the people impact of regulation, and assessing and managing organizational culture. Andrea sits on the recently established Advisory Board of Lloyds of London's Corporate University. She holds a BSc in Business Administration and Psychology, has a Hay Group accreditation in Role Evaluation and is a Six Sigma Green Belt.

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Anthony is a Principal Advisor in KPMG UK's People & Change team. His work is focused on assisting financial services organizations navigate the change agenda, and particularly the need to embed behavior change as part of regulatory-driven culture change initiatives.