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Actuaries Managing Risk

Risk Insights – Melbourne – 24 July 2014

Superannuation
Risk Culture and Risky Communication

Sean McGing, John Reid, Sabine Taylor

Quote from Australian Financial Review – 23 July 2014

Former APRA Chairman John Laker told Chanticleer:

"We're on a journey with the APRA regulated sector [of superannuation] to raise standards of governance and risk management." "And, well it's a journey."

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Part 1
Risk Culture Leadership, Measurement & Management

Sean McGing

APRA Prudential Standard SPS 220 Risk Management

Section 23 - The Risk Management Strategy (RMS) must describe:

...(f) the approach ... for instilling an **appropriate risk culture** across the RSE licensee's business operations

Quote from Australian Financial Review – 23 July 2014

Former APRA Chairman John Laker:

"What marks out a good board is its activism in embedding a strong risk culture throughout the institution.   Behaviours, not structure."

1. What is risk culture?

An organisation's risk culture describes the degree to which its culture encourages or limits the taking of risks and the opportunities that arise from those risks.

Aspects of Culture

Culture - artefacts

Culture – espoused values

Culture – tacit assumptions

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Culture – top 4 influences

1. What a leader attends to, measures, rewards and controls
2. How leaders react to critical incidents
3. Leader role modeling
4. Criteria for recruitment, promotion and retirement

Source: Schein

2. Taking a maturity approach

A culture constantly evolves through various stages of maturity

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Integral Approach to risk management

individual

collective

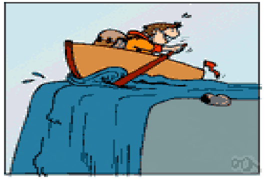
	internal/hidden	*external/visible*
	personal	**behavioural**
individual	***motivations*** ***beliefs, values*** ***intentions*** ***attitud***	***skills (IQ)*** ***knowledge*** ***actions*** ***guage***
collective	***sociological*** ***Connectivity*** ***environment*** ***teamwork***	***policies*** ***strategies*** ***processes*** ***governance***
	relational	**structural**

culture focus

Ken Wilber

Evolution of Risk Culture

	Unaware	Reactive	Mechanical	Proactive	Mature
Individual mindset	unaware	cynical	aware	integrated	risk = opportunity
Group mindset	blame	risk averse	committed	owned at work group	distributed
Behaviour	reckless	compliant	efficient	effective	strategic
Systems	none	compliance	performance	feedback	growth
Risk function	none	compliance	improvement	partner	Forward looking





Source: A. Brown and material provided by S. Bennett (Enhance Solutions). Adapted from a method by P. Hudson applied to safety cultures.

3. Risk Culture maturity across industries

Industry	*Financial Services*	*Financial Services*	*Financial Services*	*Financial Services*
Industry variation	*Banking*	*Life Insurance*	*General Insurance*	*Super-annuation*
Level of risk culture maturity	**Proactive**	**Mechanical to Proactive**	**Mechanical to Proactive**	**Reactive to Mechanical**

Industry	*Energy*	*Education*	*Education*	*Education*
Industry variation	*Combinations of Generation, Distribution and Retail*	*Primary schools*	*Secondary schools*	*Tertiary (Universities, TAFE)*
Level of risk culture maturity	**Mechanical**	**Reactive**	**Reactive to Mechanical**	**Mechanical**

4. Measuring Cultural Maturity

Why measure?

"What gets measured gets managed."

Methods of Measurement

- Surveys
- Staff interviews
- Focus groups
- External stakeholder interviews
- Social media reviews
- Review of operational processes / procedures
- Training

Quantitative + Qualitative = deeper insight

5. Our Survey Findings

1. Organisations are struggling to deal with unrelenting regulatory change and volume.
2. Organisations are grappling with managing time in the face of competing priorities in a changing environment.
3. Risk functions need to shift focus to less compliance and more forward looking .
4. Opportunity for greater partnering with business units to manage their own risks.
5. In financial services, risk appetite is not as clear as the vision for the organisation.
6. Organisations are too siloed.
7. Organisation are not tuned in sufficiently to emerging risk.

Survey results – Most important aspects of an effective risk culture

1. Tone from the top.

2. Open and effective communication in a safe environment.

3. Awareness, understanding and ownership of risk at all levels.

6. Our Insights (ERM)

1. The driving force behind best practice risk management across an enterprise is the evolving culture
2. There are more similarities than differences across industries / areas
3. Cycles are essential for learning

Recommendations

- Take the time to think ... how these findings and insights into risk culture across industries might apply to your organisation

1. Incorporate the objective of having a sound, mature risk culture embedded in your ERM policy
2. Set the desired risk appetite levels relating to risk culture against which measurements need to be compared
3. Conduct a risk culture audit annually - focus on trends, identify actions
4. Get external independent objective assessments
5. Have KPIs/KRIs related to risk culture in performance assessments
6. If can't match risk culture to risks, consider changing risk processes to work with the culture you have

Take-aways

1. Measuring risk cultures will help to navigate the course towards choosing the road we wish to walk down.
2. Three key areas to measure and manage in a risk culture are:
    - Risk ownership
    - Social coherence
    - Adapting to ongoing change – forward looking

"We shall not cease from exploration, and the end of all our exploring will be to arrive where we started and know the place for the first time."
T.S. Eliot

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Part 2
A Trustee Director perspective

John Reid

An APRA mandated RAS:
what use is it to a trustee?

Well - quite a lot

A 'mature' RAS requires the board to:

- articulate risks systematically
- decide measures and levels of acceptability
- communicate SMART expectations to management
- ensure SMART management reporting

For the first time it provides a LIVING risk document

......but most RAS's will not be mature yet

Some overarching risks would likely be described by 'handwaving' eg:

- Risk culture, adequacy of resources, member inequity, business quality

However, these risks can be measured

Actuaries are well equipped to assist with 'member inequity'

Management challenge is to bring appropriate/best practice measures to the board, and appropriate limits for these measures.

One risk has been poorly managed across the industry

Members do not understand the objective of their investment option,

and even if they did,

they may not know what it means,

and even if they did,

they don't understand the risk that it will not be achieved

This is one of the most important risks facing a trustee

- Investment managers have ever increasing sophisticated models to construct portfolios to manage risk and deliver performance
- The professionals may understand, but members still have minimal understanding of potential outcomes
- Super funds need to reverse the thinking - put the member first, and provide members with ***integrated*** performance and risk objectives that they can understand.
- Spurious precision around models and assumptions must not be the enemy of the member

Actuaries are well placed to advise trustees (and regulators)

Key questions for Trustees and regulators

- What are appropriate SMART integrated performance and risk objectives?
- What is the appropriate timeframe? Why?
- What exactly do they mean / not mean?
- Why should they stay unchanged/change over a market cycle?
- How can disclosure help a member make an informed choice between options?
- How is investment manager performance measured throughout the period?

For Discussion

Actuaries are well placed to advise trustees (and regulators) Contd

For regulators you could also add:

How is comparability across super-funds ensured?

- different performance / risk / timeframe combinations
- different models and assumptions

For Discussion

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Panel Discussion – Q & A

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