



Enhancing risk managers' strategic influence



October 2015

Enhancing risk managers' strategic influence



In their attempt to meet investor demands and successfully navigate the evolving risk landscape, a growing number of executives and board members recognize that effective and efficient risk management needs to be entrenched into the culture of their organizations.

Executive Summary

Various surveys indicate that executive decision-makers and corporate risk managers have different priorities, and may not even be speaking the same language, as concerns risk. This apparent disconnect may create a barrier for professional growth for risk managers who desire more influence in strategic decision-making. This Advisen report, sponsored by FM Global, analyzes the different risk perspectives and priorities within organizations, and provides actionable suggestions for bridging the gap and expanding risk manager influence and responsibilities.

Introduction

Across the industry spectrum, companies face a business environment bursting with opportunities but also characterized by a rapidly changing and expanding risk landscape. Challenges increasingly are of a globalized nature, exposing organizations to foreign economic conditions, local regulations and business practices, fragile and complex global supply chains, and political risks. Cybersecurity, which was barely on the radar screen a few years ago, is now top of mind for many organizations.

In their attempt to meet investor demands and successfully navigate the evolving risk landscape, a growing number of executives and board members recognize that effective and efficient risk management needs to be entrenched into the culture of their organizations. They recognize that risk management should not be seen as a bolt-on function and cost center external to a company's core businesses, but rather as an essential element of business strategy.

Enterprise risk
management (ERM)
programs attempt
to knit together the
various risk silos in an
organization to provide
a cohesive framework
for evaluating and
managing risk, but
even in companies with
viable ERM programs,
the risk manager's voice
may be only faintly
heard.

What comprises "risk management," however, as well as its perceived strategic significance, varies from industry to industry, and from company to company. Even within a company, risk management priorities, and even the language of risk, can differ sharply by role, and by differing perspectives on threat scenarios and risk tolerance within the management ranks. The risk-related priorities of the treasury department may be vastly different from those of procurement, which in turn have little in common with the risk factors faced by IT, which may only marginally overlap the concerns of the corporate risk management department. The risk-related issues of most concern to the CEO may be entirely different than the areas of concern of any of these departments.

As a result, corporate risk managers, despite their titles, may not find themselves engaged in the risk-related activities deemed most significant to the organization by executive management. Even – or perhaps especially – in organizations that place a high priority on risk management and view risk management prowess as a strategic and competitive advantage, the person with the title "director of insurance and risk management" may be viewed principally as the insurance buyer, and not a contributor to the high-level dialogue on risk. Enterprise risk management (ERM) programs attempt to knit together the various risk silos in an organization to provide a cohesive framework for evaluating and managing risk, but even in companies with viable ERM programs, the risk manager's voice may be only faintly heard.

Should risk managers be concerned that the focus of the insurance and risk management function may be very different than the risk priorities of the C-Suite? What more can risk managers do to highlight the contributions they make? Could they be contributing more under different circumstances? Do risk managers need to augment their knowledge base and improve their skill sets to earn "a seat at the table" for strategic risk-related decisions?

To answer these questions, Advisen interviewed risk managers and chief risk officers, analyzed various studies concerning CEO risk-related priorities, and called upon various RIMS surveys, conducted by Advisen, on the changing roles of risk managers, especially within the context of enterprise risk management (ERM) programs. The answers are complex – depending in part on the industry group an organization belongs to, but even more so on risk managers' aspirations and willingness to challenge the status quo, senior management and board of directors' attitudes towards risk and risk management, how thoroughly risk management is embedded within an organization's corporate governance framework, and how effectively risk managers translate their risk vocabulary into the language of growth and financial performance spoken by the C-Suite.

Risk managers who want to increase their influence and augment their role may have an unprecedented opportunity to do so as risk-related issues increase in visibility and significance in many organizations, and as a growing number of organizations create chief risk officer or similar executive-level roles.

The consistent message that emerged is that, in their traditional role, risk managers perform an essential function that is largely undervalued. In one sense, risk managers are victims of their own success – since most perform their jobs well, executive management rarely needs to be concerned about those risks and can turn their attention elsewhere. However, even without changing or enlarging their role, risk managers could be more effective in communicating their value – and potentially expanding their influence – by translating the impact of their activities into the financial terms the C-Suite uses to help guide strategic and tactical decisions.

Risk managers who want to increase their influence and augment their role may have an unprecedented opportunity to do so as risk-related issues increase in visibility and significance in many organizations, and as a growing number of organizations create chief risk officer or similar executive-level roles. Many organizations, however, do not reflexively look to the corporate risk manager to fill that role and competition can be stiff from candidates with compliance, finance or legal backgrounds.

Risk-related concerns of the C-Suite and the board of directors

The good news for risk managers is that most CEOs take risk management quite seriously. A KPMG survey found that risk management is the second-highest concern about the company for CEOs (following financial performance).¹

The risk factors that most concern CEOs, however, tend to have little in common with the types of risk addressed by the insurance and risk management department. CEOs tend to be most concerned about external economic, political, technological and regulatory risk factors, according to various studies and surveys. A PwC survey found that the top concerns were "uncertain or volatile economic growth," "government response to fiscal deficit and debt burden," and "overregulation." The KPMG study found the CEOs it interviewed also were highly concerned about the regulatory environment, and in fact were more concerned about overregulation than they were the economy. Additionally, they worried about their companies staying relevant in an environment characterized by near-constant disruption. "Unless there is an imperative imposed upon the company by some external factor, the CEO is really going to be focused on the issues that their shareholders are going to hold them accountable for, and by proxy their equity analysts," explained Prakash Shimpi, former CRO of ING US and presently a member of the US Treasury's Financial Research Advisory Board, formed under Dodd-Frank.

One area where CEO and corporate risk management concerns were closely aligned was cyber risk. PwC found that cyber threats caused the sharpest uptick in worry for US CEOs.

One area where CEO and corporate risk management concerns were closely aligned was cyber risk. PwC found that cyber threats caused the sharpest uptick in worry for US CEOs.³ Advisen surveys have revealed that concern over cybersecurity has increased sharply among corporate risk managers, who increasingly find they are involved in helping to solve cyber risk issues that until recently were perceived as exclusively the domain of the IT department.

Boards of directors also express concern about cyber risk. According to a survey by the NYSE Governance Services along with Spencer Stuart, only 3 percent of directors surveyed expressed confidence in their organizations' ability to manage cyber risk and only 19 percent were very confident they could handle social media risk. According to the same survey, shareholder activism was identified as a significant risk.⁴

Is there disconnect between the risk priorities of the C-Suite and corporate risk management?

The term "risk manager" can mean different things in different organizations, and varies to a degree by industry. In banking, for example, the person with the title "risk manager" may be primarily focused on mitigating investment risks, while in healthcare the focus may be principally on clinical outcomes and patient safety. While not excluding these other risk management functions, for the purposes of this report, "risk manager" is most closely aligned to the "director of insurance and risk management" function found in many organizations. According to RIMS, "this person typically owns the process of identifying, measuring and managing insurable or hazard risks, developing reports and plans, and analyzing risk/ insurance problems and defining and/or overseeing the implementation of the risk solutions that help optimize operations."⁵

Risk can be categorized by a variety of schema according to the needs of an organization. One common schema used for enterprise risk management purposes divides the spectrum of risks faced by an organization into four categories: hazard risk, financial risk, operational risk, and strategic risk. Hazard risk – typically liability and property-related exposures – has been the traditional home of the risk manager, as the RIMS definition clearly states. For organizations other than banks and other financial institutions, financial risk is often the domain of the treasury department or the chief financial officer. Strategic risk falls squarely on senior management. Operational risk is usually widely distributed throughout an organization, including human resources, internal audit, and information technology.

The C-Suite is directly accountable for strategic risk, but the CEO and other senior executives presumably are also concerned about every other risk that poses a threat to the organization. With the exception of cyber, however, rarely do the areas of risk addressed by the corporate risk manager hit the radar screen of executive management.

The C-Suite is directly accountable for strategic risk, but the CEO and other senior executives presumably are also concerned about every other risk that poses a threat to the organization. With the exception of cyber, however, rarely do the areas of risk addressed by the corporate risk manager hit the radar screen of executive management.

"Risks such as product liability and management liability certainly hit the C-Suite and they understand those issues," explained Shimpi. "I'm not confident that beyond recognizing that it's an issue and is something they need to get coverage for, they actually delve into the minutia and details of those risks unless some circumstance such as a loss occurs and they have to focus on it for that moment."

That is as it should be, according to William Fealey, director of risk management for Dover Corp. "If I am doing my job well, the CEO shouldn't have to worry about whether we have the right insurance coverage, and can focus on other things."

Shari Natovitz, SVP, director of risk management at Silverstein Properties, sees the risk management function vis-à-vis executive management similarly. The C-Suite looks to the risk management department to "take as much risk off the table [as possible] so they can pursue those areas where there is speculative risk."

The risk manager's contribution may be misunderstood and undervalued, according to Shimpi. "Insurance is essentially a financial instrument – a hedge," but neither the risk manager nor the C-Suite typically think about it in those terms. "Think of risk management as a piece of a firm's corporate finance puzzle," and its perceived value changes.

Natovitz notes that language is important in communicating the value of risk management. "Many risk managers come up through the insurance industry, and are taught the language of risk transfer and how to communicate with an insurance carrier. That's not what we're talking about," when communicating with executive management, she observes. Natovitz recommends expressing the value of risk management activities as to their impact on EBITA (earnings before interest, tax and amortization) or, for a public company, earnings per share. "If you can't translate what you do into the way your own company measures and values its own success then you're never going to be valued within that equation."

While being able to communicate value in terms that resonate with executive management is essential, a Harvard Business School study found that establishing a common language for risk throughout an organization is a key success factor for risk management programs.⁶ Dover Corp's Fealey concurs on the significance of language. "It's important to be able to

A 2013 survey by
Advisen and RIMS
found that 63 percent of participating
companies had either
partially or fully
implemented ERM
programs, continuing
the upward trend in
ERM adoption, from
54 percent in 2011
and 36 percent in
2009.

communicate upward and to have a common vocabulary," he observes. For large, complex enterprises it is also essential that the risk manager be able to speak specifically to the issues of the various units in terms that they can relate to. "We have a collection of approximately 40 businesses," he notes. "It's important that I look at each of the businesses and break [the risk factors] down into something that makes sense to each of them."

Whether or not risk managers are speaking the right language, structural impediments can stand in the way of being heard and appreciated by executive management, according to Andrew Bole, chief operating officer of Global Prime Partners and former CRO of IG Group Holdings. "There is no real conversation without a forum," he notes. Risk managers have the most influence in companies where risk management is explicitly incorporated into the corporate governance structure. Bole also recommends including risk management topics in informal board training sessions.

Risk managers and ERM

Enterprise risk management, or managing organizational decisions and activities through a strategic risk discipline across a full-risk spectrum, is an idea whose time has come. A 2013 survey by Advisen and RIMS found that 63 percent of participating companies had either partially or fully implemented ERM programs, continuing the upward trend in ERM adoption, from 54 percent in 2011 and 36 percent in 2009.

On the surface, ERM programs would seem to be a vehicle for risk managers to extend their influence throughout an organization and become more involved in a wider range of strategic risk-related decisions. Remarkably, in a few organizations surveyed by Advisen, the risk management department had no role in the organization's ERM activities, but for many risk managers, this does not seem to be the case. Of the risk managers responding to the 2013 Advisen/RIMS survey, 56 percent said that it is the risk management department that is primarily responsible for directing ERM activities in their organizations.⁷

Shimpi warns, however, that engagement through an ERM program doesn't necessarily mean that a risk manager will have greater input into risk-related strategic decisions. Too often companies adopt an ERM framework without considering whether the most significant risks being faced by the organization are in fact being identified and addressed. In those cases, ERM becomes a box to be checked to satisfy regulators, rating agencies or shareholders, but not an integral part of the strategic risk management process. That may be one reason why, according to a 2013 KPMG survey of C-Suite executives, less than half believe their company's risk management program is effective.⁸

Experts agree that,
even within the
traditional insurance
and risk management
function, risk
managers perform
an essential role,
though it may be
misunderstood
and undervalued
by executive
management.

Extending the risk managers' influence in risk-related strategic decision-making

Some risk managers are content with the traditional insurance and risk management role and functions – buying insurance, managing captives and other alternative risk financial mechanisms, managing claims within the organizations' retention, etc. Others, however, may aspire to a broader role and "a seat at the table" for risk-related decisions affecting key strategic decisions. A few have joined the C-Suite themselves as chief risk officers or a similar role.

Experts agree that, even within the traditional insurance and risk management function, risk managers perform an essential role, though it may be misunderstood and undervalued by executive management. Translating risk transfer and risk financing activities into the language of the C-Suite can go a long way in gaining greater recognition and appreciation into the contributions of the risk manager, and may open up a more productive dialogue between the risk manager and executive management and the board of directors.

Shimpi notes that thinking of insurance as a financial management tool also may open up creative new possibilities for addressing a broader range of risks. The risk manager, however, must be attuned to those possibilities and have the skills and knowledge to understand the potential. He points to a deal he helped to structure with a Canadian grain company where the risk of a drop in grain volume – the most significant financial threat faced by the company – was insured along with the more conventional property and liability exposures.⁹

While insurance may be a financial management tool, a hurdle for risk managers, rightly or wrongly, is that the C-Suite may not view them as financially sophisticated. It can be a bit tricky for a risk manager to overcome, explains Shimpi. For senior executives to view them as a player it helps if risk managers can communicate how that expense line called insurance premium affects capital.

Whatever the level of their ambition, risk managers often struggle to have their voice heard in the cluttered din of a typical large organization. Bole observes that boards and executive management in many organizations still fail to fully understand how risk managers contribute to shareholder value. They typically do not seek out the risk manager's input, leaving it to the risk manager to navigate the organization to find opportunities to demonstrate their value. "Because risk management is not valued any differently than anything else that is considered back of the shop, but is involved in the infrastructure that allows it to perform with the least amount of risk, what we do is not going to be seen as valuable unless that value is communicated," said Natovitz.

Risk managers need to be able to translate their value into the financial perspective of the C-Suite, while at the same helping to create a common language of risk throughout the organization to knit together silos of independent risk mitigation activities.

Natovitz notes that, earlier in her career, executive management considered the risk manager a "downstream party." She is now a member of her company's executive committee and a member of the C-Suite. She attributes her rise in the organization to a sustained process of educating management in risk management issues and "for being a willing and effective repository for those things that they need solutions for that they can't figure out who else to go to for.... Anything that doesn't fit into a slot ends up coming here."

Natovitz also recommends that risk managers find a champion in the C-Suite, particularly the CFO. "If you have the champion, and you can identify where you can help eliminate vulnerabilities for your company and produce results, the champion can help communicate those results in terms of a specific benefit," Natovitz explains. "If you can do this, then I think you are halfway up the ladder to making sure risk management becomes a valued part of what the company does."

Conclusions

The Harvard Business School study of effective risk management programs concludes that "calls for ... the formal inclusion of senior risk officers in the C-Suite might be misguided." Success should rather be quantified in the "ability to bring about consequential risk talk where it matters, in the business lines, helping those who carry out the real work of risk management – managing risks." ¹⁰

Risk managers probably should not be concerned that the risk issues at the top of mind of the board and the C-Suite are different from the risk issues that occupy their day-to-day activities. In fact, they probably should be more concerned if the issues were more aligned – that likely would mean that the risk manager was not succeeding in his or her role. The spectrum of risk faced by most organizations is broad. It is the role of the risk manager to narrow the spectrum to allow executive management to focus on the more speculative and strategic risks and not to be concerned about the risks that can be mitigated by traditional risk management techniques.

That said, the risk manager nonetheless has the opportunity to deploy his or her skills more broadly throughout an organization and help to create a more unified perspective of risk and a coordinated approach to its management. Risk managers need to be able to translate their value into the financial perspective of the C-Suite, while at the same time help to create a common language of risk throughout the organization to knit together silos of independent risk mitigation activities. They cannot expect to be offered the opportunity to take "a seat at the table" for risk-related strategic conversations without making a concerted effort to

enhance the risk dialogue throughout the organization, educate executive management and the board of directors on risk issues and the contribution of the risk management department, and, when they catch the attention of executive management, be willing to take on tough assignments resulting in demonstrable value to the organization.

"The C-Suite pays attention to value," advises Natovitz. "Either risk eliminated, opportunity created, or cost reduced." ■

- ¹ Setting the course for growth: CEO Perspectives, KPMG http://www.kpmginfo.com/ceo-study/documents/ceo-study1.pdf
- ² What concerns CEOs: 16th Annual Global CEO Survey, PwC http://www.pwc.com/gx/en/ceo-agenda/ceo-survey/key-findings.html
- ³ "Concern over cyber threats has CEOs warming to government collaboration," PwC http://www.pwc.com/us/en/ceo-survey/secure-assets.jhtml
- ⁴ "Cyber Risk, Shareholder Activism Lead Board Concerns," CFO http://ww2.cfo.com/governance/2015/03/cyber-risk-shareholder-activism-lead-board-concerns/
- ⁵ Sample Position Descriptions, RIMS https://www.rims.org/resources/CareerCenter/Employers/Pages/SamplePositionDescriptions.aspx
- ⁶ Anette Mikes, *The Triumph of the Humble Chief Risk Officer*, Harvard Business School, May 23, 2014
- ⁷ In some cases it appears that risk managers may be early champions of ERM, and take the lead in the first phases of ERM implementation, but may not be the long-term choice for managing a mature ERM program. Indeed, between 2011 and 2013, the percentage of programs led by risk managers fell by 3 points.
- ⁸ Expectations of Risk Management Outpacing Capabilities It's Time For Action, KPMG, May 2013
- ⁹ See "Outsourcing capital," The Economist, November 27, 1999
- 10 Anette Mikes, The Triumph of the Humble Chief Risk Officer, Harvard Business School, May 23, 2014