



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

CRO Forum Address

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L-R: Padraic O'Malley (Milliman), Marie Louise Delahunty (Central Bank of Ireland), Eilish Mattison (Central Bank of Ireland) and Eamonn Phelan (Milliman) at the CRO Forum on 21 February 2018.

Good morning and thank you to Insurance Ireland for inviting me here this morning to talk to you about some key risks areas of focus that we see on the horizon for the Insurance sector.

For those of you who don't know me, my name is Marie Louise Delahunty. I am recently appointed as Head of Insurance Supervision. I have worked in Insurance Supervision for the past six years. Over that time, I have been involved in the supervision of every Insurance sector regulating both domestic and Insurance Groups. I am a qualified accountant, I trained with PwC and worked with them for 10 years prior to joining the Bank.

Before I discuss the risk landscape and the regulatory key focus for 2018, I would like to briefly look at some of risks that materialised in 2017 and ask how well did you responded to them?

In February the scale of the Ogden rate change was a surprise. Did you ever consider a scenario where there was such a significant increase? How quickly were you able to assess the impact?

The first full cycle of regulatory reporting completed last year. Are your reporting processes robust; is there strong reporting governance in your business? Do you monitor the accuracy of QRT reporting?

Is Board succession planning a risk you need to monitor? We have noted a large number of INEDs approaching their 9 year limit. How will your Board manage the challenge of finding a suitable replacement? Is this a Risk for your business?

Likewise in December the US Tax changes caught us all by surprise. Do you have the framework in place to effectively manage these kind of surprises?

We have all seen an increase in the activity and responsibility of the Risk committees of the Board, as well as a growth in the importance and scale of the contribution of the risk function. In parallel with this is the growth in size of the risk function.

Understanding the Risk Culture in an organisation is a hot topic and has been commented on by many including the CRO Forum in September 2017 when it published its guidelines on “Defining, Embedding and Managing Risk Culture”.

One area this paper talks about is the importance of communication. I would like to talk this morning on the importance of effective communication by the Risk function, particularly the CRO with the Board.

CRO Communication with the Board

The ever-increasing busyness of the Board makes it more of an imperative that the risk function is communicating effectively and timely with the Risk Committee and the Board in order to engage them and move them to respond.

How would you assess the effectiveness of your communication with your Board? Are you and the Board willing and able to discuss key risk issues appropriately?

In an ideal scenario, the communication with the Risk Committee and the Board will lead to a situation where there is appropriate challenge of the status quo and a search for ways to improve risk assessment and measurement leading to a constant strengthening of the risk culture.

Adequate preparation and understand the audience in order to be able to frame the conversation is useful not just for Board meeting but also for individual meetings;

An effective CRO must be able to:

1. Listen to executives (non-risk professionals) and identify where there are gaps in the understanding;

2. Translate risk management terms into understandable business language and develop a common language, keep it concise and relevant;
3. Propose solutions, use data to illustrate the consequences;
4. Ensure the risk function is an active participant in strategic decisions

(Above from RIMS, January 2018 report)^{nx}

To be able to achieve this successfully you need the support of a resilient and diverse team.

Building resilient teams

Ensuring resilience in a complex business environment places a premium on the importance of social capital to fall back on in a time of crises - team composition and cohesion is a strong source of resilience. The CRO must have the support of a strong resilient RISK team. Studies show that resilient teams are founded on a diversity of skills among team members and well-articulated and implemented governance. Im going to look at team diversity and governance in turn.

Team Diversity

It is widely acknowledged that a lack of diversity of thought increases the risks of groupthink, poor decision-making and can have a negative impact on the culture in a business; this in turn increases the risk of poor customer outcomes and can have detrimental consequences on the financial performance of a business.

Insurance Ireland have just completed a year of inclusion focusing on some of the different dimensions of diversity. And in order to promote transparency around diversity issues, last year the Central Bank released statistics on the gender breakdown of fitness and probity applications. From this, we saw that 82% of applicants to PCF roles in the insurance sector were male – this was the highest percentage across all regulated sectors and demonstrates that the sector still has a significant gap to bridge to come close to parity.

It is worth noting however that in the complexity of a decision making process it is inherently difficult to isolate a single dimension of diversity and pin point its role in that decision making process. Nonetheless, the most noted benefits to diversity centre on the fact that:

- diversity increases the robustness of a group and
- it drives innovation and productivity

So how does diversity achieve these benefits? Put simply diversity ensures a broader range of solutions are considered and evaluated increasing the likelihood of a more successful outcome and contributing to improved strategic decision making.

Diversity in skillset is also an asset with IT competence shown as a factor in positively influencing innovation strategies. Diversity in teams overall leads to improved decision-making and more innovative solutions. And the business value in having a more diverse workforce is also linked to a better design of products and customer service.

The important thing to remember is that diverse team members bring their own unique qualities that create additional value.

As a CRO it is important to consider who are you hiring into CF roles and the risk teams. Do you hire individuals that will challenge constructively or go with the flow?

What is your team's communication style? Is it effective?

How mature is your risk function – are you self-identifying issues or are you relying on internal audit and maybe your supervision team as a diagnostic?

I also mentioned that well articulated and implemented governance is a factor in building a resilient team. It is also a key aspect of the risk culture of your business. Risk culture is a key area of focus for us in supervision. We have developed a risk culture assessment model. Governance is a key aspect of this model.

Governance

Risk Culture Assessment (RCA) Governance

You will see the four aspects of this risk culture model will be explored in more detail over the coming months through articles in our quarterly newsletter with 'leadership' having already been profiled in our December 2017 edition. Governance is the next factor that will be addressed in our March edition.

First thing to address regarding governance is the risk management framework - what risks do you have, what does your risk profile look like? Are you taking an expansive enough view of the risks that could affect the business?

Underneath that what does your risk reporting system look like? Regarding the thresholds that have been set, do they make sense? Error and near miss reporting is a treasure trove of information. There's plenty of talk about data mining and the insights it can give you – with a well-functioning error/near miss reporting system you have insightful data waiting to be mined.

By adopting the right perspective and conducting considered root cause analysis you can open the door to the development of more efficient practices be they more specific training, redesigning systems or simple solutions such as disabling auto complete on outlook to reduce the risk of sending emails to the wrong person.

If a risk management framework, a structure, is in place, the next, complimentary, aspects to address are responsibility and accountability. These will help drive the behaviour that is needed to support the risk management structure.

With regard to responsibility - who, individuals or committees, is responsible for particular risks? How are people/committees informed of these responsibilities – are role profiles and ToRs up to date? Are responsibilities clear and unambiguous?

There needs to be transparency across the organisation about who is responsible for what. As CROs you need to ask yourself, when issues arise in your institution, as they do, are staff aware of who to turn to?

If not, then there is a risk of something falling through the cracks resulting, at one end of the spectrum, in a major, material incident or at the other end of the spectrum a lost opportunity to capture a learning that could improve how you operate – on its own it may not seem much, however, enough small improvements can make a big difference.

The next thing to consider is how are these individuals/groups held accountable? Important to note that accountability goes two ways – it's very easy to get bogged down on the negative side of things, that is doling out punishment when people have not lived up to their responsibilities however, what about those who fulfil their responsibilities as intended – is this performance acknowledged and rewarded?

We reference role-modelling a lot when we talk about culture so are you as CROs, are your peers in senior leadership demonstrating that a job well done is appreciated or do they just pay attention when things go wrong?

If it's just the latter, then you have to consider what sort of message that's sending to your colleagues and what behaviours that could drive such as non-reporting and covering –up.

Likewise, you need to demonstrate that if people are engaging in behaviour that is not in keeping with the responsibilities they are challenged and held accountable according to the stated policy and that this occurs consistently across business units and regardless of seniority. You can have all the best structures in place, however, without the complimentary behaviours, they are just nice plans on paper.

As CRO's you lead the way in terms of influencing the risk culture in your organisation through your leadership, governance, competency and decision making. Having a resilient and diverse team in place as well as being able to communicate effectively are key strategic enablers to success in your role.

I would like to look now at some of the key risks we see in 2018 and our priority areas.

2018 Key Risks and CBI Priorities

If you look at the World Economic Forum (WEF) January 2018 report^{nx}, key risks identified for business in terms of likelihood are Environmental (Extreme weather, Natural disasters, failure of climate change mitigation), and Technological (Cyber/Data fraud or theft).

The overall Geopolitical environment can be added to this list as a key challenges facing the insurance sector.

Additionally, as the pace of change and the complexity of interconnections between businesses accelerates, the challenges with forecasting and understanding the risks are also growing. Particularly as we see risks combining with cyber risks to create hazards that are continually evolving.

I would like to focus on a few risks that are significant for the Irish regulated entities:

Geopolitical Risk

Geopolitical developments continue to cause ripples across the business environment with geopolitical volatility a key driver of uncertainty on companies risk registers.

Brexit

The implications of Brexit on the some companies' business model brings significant challenges for the upcoming year and into the future. As a key focus the Central Bank, will continue to challenge companies on their Brexit preparations and the timeframe for implementing contingency plans.

You cannot assume that Government negotiations are going to work in your favour. Are you considering the implications of both a hard and soft Brexit? Do you think your plans will adequately protect your customers and your business?

IT Risks

Cyber Risk has been discussed in detail already however is worth noting that, the "2017 annual cost of cyber-attacks is triple 2017 Nat Cat bill"

InsureTech/FinTech

In the first half of 2017, investment in Insuretech amounted to \$400m, up from \$50m in 2016^{nx}. With many companies forming partnerships or outright acquisitions of Insuretech companies. In such an active M&A environment it is key that due diligence is executed in this space as companies rush in to become market leaders and harness disruptive technologies.

Caution and analysis is required for example the fitness app Strava discovered that its global heatmap of users fitness routes highlighted key US military bases in the middle east. This brings to mind the risk of unintended consequences with the use of user data and the internet of things (IOT).

Under Operational risk how many of you have policies for users on IOT? Most everyone at this stage has policies on social media but we have yet to see how much the interaction of IOT has been considered by companies to-date?

Should you consider this from your company's perspective given the proliferation of connected apps and the potential of sizeable fines from the forthcoming GDPR legislation on user/customer data protection? This example may demonstrate that "aggregated anonymised utilisations trends" may turn out to be more revealing and less anonymised than first thought.

One of the key implications of the growth of Insuretech is the fact that financial firms are becoming ever more reliant on information technology for their business success.

The Central Bank has brought together our specialist resources from the different sectoral area into one centralised IT inspections team. The Insurance directorate will be leveraging this resource and has a number of IT inspections scheduled for 2018.

I would encourage information sharing on IT & Cyber incidents with supervisors.

Regulatory response:

Speed and agility to respond to the changing environment is not just for companies, but for the regulator too.

The CBI is actively working in the FinTech space with a cross-bank working group, which seeks to understand the nature, benefits, and risks of different areas of innovation and to develop an appropriate regulatory approach.

The cross-sectoral working group within the Central Bank has been working to develop a picture of current FinTech activity in the Irish context and in the Insurance market.

Specific to the Insurance sector, the Central Bank is an active participant in the Eiopa Insuretech working group. We know that

- InsurTech has an impact across all of the steps of the value chain in the insurance and pension sectors, transforming business models through financial innovation and technology.
- Regulatory and supervisory authorities have a role to play, by encouraging financial innovations while, at the same time, ensuring a well-functioning consumer protection framework and financial stability.
- The Central Bank is working with other European regulatory and supervisory authorities to help foster innovations while, at the same time, working to ensure a well-functioning consumer protection framework and financial stability.

The EIOPA multidisciplinary team will be reviewing key aspects of InsurTech in 2018 such as:

- **Thematic review of Big Data:**
 - Analyse the benefits and potential risks of Big Data to fair treatment of consumers
 - Assess the impact of Big Data on the availability and affordability of insurance for consumers.
- **Cyber Risks:**
 - Increase understanding of cyber risks, their impacts as well as new opportunities and challenges that cyber risks imply for the sector.
- **Mapping supervisory approaches to InsurTech:**
 - Determining efficient and effective supervisory practices and identifying possible regulatory barriers to financial innovation.

Outsourcing

Outsourcing is a key area of focus for supervision particularly in an environment where outsourcing parts of the value chain can significantly improve the profitability of a business.

In the Central Bank, a cross sectoral assessment is on-going at the moment and is in the initial data gathering phase. This review will consider the extent of concentration and country risk exposure to firms and industries; the prevalence of any other risks associated with outsourcing and the level and adequacy of controls and measures in place to reduce outsourcing risk. This will establish a baseline view of outsourcing arrangements, both with third parties, and inter and intra-group arrangements which in turn, may inform the development of regulatory guidance and future policy formulation.

Last year our onsite team completed a thematic review of outsourcing in the cross border life sector.

The inspection considered the governance and operational risk of outsourcing arrangements in place with respect to seven cross border life insurance undertakings and their third party administrators. The focus of the inspection was to consider the appropriateness of governance and oversight of outsourcing arrangements in place, and to consider the strength of processes and controls in place, including unit pricing and errors handling.

The thematic inspection identified that weaknesses exist in the following areas:

- Board and Committee oversight in relation to performance of outsource providers;
- Roles and responsibilities of three lines of defence including the Risk Function and Internal Audit Function with respect to oversight of outsourced activities;
- Business continuity and exit planning undertaken by companies to ensure appropriateness of arrangements in place and alignment with the companies risk appetite and business needs.

Weaknesses identified in relation to the role of the risk function centred on

1. A lack of quality review of operation of controls,
2. lack of consideration of outsourcing risk in RAS/Risk register,
3. lack of regular qualitative outsourcing updates to Board/Risk Committee

How do you think your Risk Function monitors outsourcing arrangements?

This year our on-site inspections team will focus on the risk management framework in Groups. This will include a review of the risk function, the role of the chief risk officer and an assessment of the risk culture in the business. In terms of risk culture we will look at how decisions are made, how they are communicated, how this reflects in the risk management framework and how actions are implemented on the ground.

The team will also perform a business model analysis of cross border business. The work will concentrate on companies selling business on a cross border basis through Managing General Agents as a distribution channel. The focus will be companies selling non life products to small businesses and consumers.

Conclusion:

Just to conclude today, 2018 has started with a little more buoyancy than previous years. Results of a recent PWC CEO Survey^{nx}, point to a significant jump in CEO optimism regarding global growth prospects over the next twelve months, (the survey showed a jump from 29% in 2017 to 57% in 2018 of respondents who felt that economic growth would improve).

While the biggest jump in optimism was in the North American market, European counterparts were not far behind.

PWC also add that “the last time North American CEO’s were this exuberant was in 2007, the year before the financial crisis”.

The role of the CRO in the face of this optimism is to be the voice of reason in the search to leverage the opportunities and to provide internal constructive challenge.

Good governance over the assessment and management of risks, including the upside of risk, is key.

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