

To: Financial Stability Board, Basel (fsb@bis.org)

Date: January 31, 2013

Re: CRO Council response to Consultative Document on Guidance on Supervisory Interaction with Financial Institutions on Risk Culture from 18 November 2013

The North American CRO Council (CRO Council) welcomes this opportunity to respond to the Consultative Document on “Increasing the Intensity and Effectiveness of Supervision” published by the Financial Stability Board (FSB) on 18th November 2013. The CRO Council is a professional association of Chief Risk Officers of leading insurers based in the United States, Bermuda, and Canada. Member CROs represent 30 of the largest Life and Property and Casualty insurers in North America. The Council seeks to develop and promote leading practices in risk management throughout the insurance industry and provide thought leadership and direction on the advancement of risk-based solvency and liquidity assessments. Further information on the CRO Council can be obtained at <http://www.crocouncil.org>.

The CRO Council agrees with Financial Stability Board’s (FSB) emphasis on the need to strengthen and promote risk culture across financial institutions. Indeed we espouse similar views and are in the process of developing a public whitepaper on risk governance and cultural practices. At the same time, we believe that a level of natural variation rightly exists amongst financial institutions across aspects of risk culture and risk management practices; this is often attributed to differences in organizational size and strategic direction, business complexity, level of risk tolerance, local culture as well as current and target risk positioning. Accordingly, we recognize that there is no single correct approach to risk management and a number of approaches can be deemed appropriate as long as these approaches account for and acceptably mitigate the risks to which a firm is exposed.

We agree that strengthening risk culture is critically important for effective risk management and emphasis should be placed on providing an environment of effective challenge while enabling risk taking within agreed dimensions. We agree that risk culture is nuanced and can vary across companies and geographies and that tone from the top, accountability for decisions / actions, a collaborative environment that allows for effective challenge, and aligned incentives are amongst the critical dimensions of risk culture. We agree that supervisors should consider risk culture while assessing the risk management capabilities of individual firms. We would, however, like to provide our recommendations in the hope that you find it constructive and insightful as you develop your guidance on supervisory interactions with Financial Institutions on risk culture. The Council proposes a number of suggestions for the FSB to consider in order to enhance the clarity and usefulness of the paper.

The following areas for consideration are presented in the order in which they were presented in the FSB's paper:

“Differences in risk culture might be driven in part by differences in corporate and also national cultures.” (page 1)

The Council agrees that risk culture can rightly vary from company to company and across geographies. Notwithstanding this, we are concerned that the approach taken within the paper, for instance by the bullet-point categorization of leading indicators of an effective risk culture, may lead to prescriptive requirements along isolated aspects of risk culture and the development of box-checking compliance mechanisms in this regard. We believe additional clarification and/or rewording is needed to properly caveat the nuances and amorphous nature of risk culture as well as the wide range of factors that support development of an effective risk culture.

“Assessing risk culture entails identifying the root cause of why there are supervisory findings – not just what the findings are.” (page 4).

Clearly risk culture should be considered as a potential cause for supervisory findings. However, we believe additional clarification is needed; our concern is that this guideline could lead to lengthy reviews of the “intent” of actions which led to a risk failing as opposed to focusing on the actions and circumstances which caused the risk failings.

“It includes identifying practices, behaviors or attitudes that are not supportive of sound risk management and intervening early to address these culture observations...The underlying causes of these findings should be embedded in supervisory reports and discussed with the board and senior management.” (page 4).

We agree that aspects of risk culture should be considered for soundness. However, this also affords the potential that various cultural dimensions will be mandated and can potentially lead to extensive “box-ticking” requirements. We believe additional clarification and/or rewording is needed. The intention shouldn't be to mandate or evaluate individual risk culture dimensions but rather to comprehensively evaluate whether organizational risk culture enables effective risk management.

“The board and senior management demonstrate a clear understanding of the quality and consistency of decision-making throughout the business, including how decision-making is consistent with the financial institution's risk appetite and the business strategy.” (3.1.9)

We believe this statement is vague. Specifically, “quality” is not clearly defined, and risks being measured by an evaluation of the consequences of decision-making. We believe additional clarification and/or rewording is needed. We believe the role of the supervisor should also be clarified. We suggest removing the term ‘quality’ and adding ‘supervisors’, i.e. “The board, senior management and supervisors demonstrate a clear understanding of the alignment of decision-making with the

institution's risk appetite and business strategy, as well as the appropriate consistency across businesses."

"The board and senior management have clear views on the business lines considered to pose the greatest challenges to risk management, such as unusually profitable parts of the business, and these are subject to constructive and credible challenge about the risk-return balance." (3.1.10)

We believe this statement can be misleading. Unusually profitable parts of the business may not necessarily be misaligned with or pose challenges to organizational approach to risk management. We believe additional clarification and/or rewording is needed. We suggest removing the phrase "unusually profitable parts of the business" and replacing it with "business lines with unexpected or unexplained results", i.e. "The board and senior management have clear views on the business lines considered to pose the greatest challenges to risk management, such as business line with unexpected or unexplained results, and these are subject to constructive and credible challenge about the risk-return balance."

"The board and senior management systematically monitor how quickly issues raised by the board, supervisors, internal audit, and other control functions are addressed by management." (3.1.11)

We believe speed shouldn't be the only metric of interest. Issues should ideally be addressed in line with ability and priority. We believe additional clarification and/or rewording is needed. We suggest "The board and senior management systematically monitor how effectively issues raised by the board, supervisors, internal audit, and other control functions are addressed by management."

"Assessment and communication of lessons learned from past errors is seen as an opportunity to strengthen the institution's risk culture, and to enact real changes for the future." (3.1.13)

As written, this could be misconstrued as stating that risk culture changes should be undertaken every time a failing occurs. We believe additional clarification and/or rewording is needed. We would also suggest that equally important lessons may be learned from success as well and that the language could be amended along the line of "...lessons learned from past errors and success is seen...."

"Whistleblowing is proactively encouraged and supported by the board and senior management, and understood by employees as part of an effective compliance framework; the treatment of whistle blowers is clearly articulated and followed in practice." (3.2.7)

We agree that whistleblowing has an important role in maintaining a vigilant and compliant approach to risk management. Notwithstanding this, "whistleblowing" assumes that normal issue reporting practices are ineffective and/or efforts to actively hinder or thwart risk management exist. We believe additional clarification and/or rewording is needed to adjust the tone.

"Remuneration and performance metrics consistently...encourage employees to act in the interest of the greater good of the company, rather than themselves or their business line." (3.4.1)

Remuneration and performance metrics play a role in incentivizing employee alignment with organizational attitudes. However this verbiage seems to assume that individuals, business lines and companies have opposing interests. Performance and remuneration metrics should be aligned so that when individuals act in their own best interests, it is aligned with their business lines and the greater good of the company. We believe additional clarification and/or rewording is needed to adjust the tone.

*Evidence of a culture that is open to dissent is often reflected in decision-making processes.” (page 8)
“Senior management has mechanisms in place to ensure that alternate views can be expressed in practice, and requests regular assessments of the openness to dissent at all layers of management involved in the decision-making process.” (3.3.2)*

Clearly risk culture should be flexible towards the consideration and incorporation of alternate viewpoints.

Emphasis on “dissent” should ideally go hand in hand with collaboration and creating a collegial environment; both necessary components of effective risk management. We believe additional clarification and/or rewording is needed to adjust the tone. 3.3.1 and 3.3.2 should be potentially reworded to include the notion of collaboration, for instance, an effective culture should encourage the fact that each employee’s view is valued and the organization works together to strengthen risk-related decision-making.

“Succession planning processes for key management positions include risk management experience and not only revenue-based accomplishments; for instance, the chief risk officer can be considered as a potential candidate for chief executive officer.” (3.4.5)

In the given context, singling out the chief risk officer as a potential CEO candidate seem to imply that the chief risk officer is currently precluded from consideration. CEO candidacy should be based on inherent abilities, business acumen and overall fit for the role – the best person for the job should be considered, no matter whether that person is functioning as the CRO, CFO or in any other role. We suggest removing the example concerning the candidacy of the CRO. At a minimum, we believe additional clarification and/or rewording is needed.

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Once again, we thank the FSB for the attention brought to these comments and look forward to a constructive dialogue with our supervisors on the topic of risk culture.

Yours sincerely,

Steve Verney
CRO Council Chair