THE CHANGING ROLE OF THE RISK MANAGER

September 2013

Sponsored by:

THE CHANGING ROLE OF THE RISK MANAGER

Executive Summary

An ever-evolving risk landscape combined with a heightened emphasis on the strategic importance of risk management mean that the roles and responsibilities of many risk managers are changing at a rapid pace. In many organizations, risk managers are becoming more visible and more engaged in strategic decision making, but for many risk managers that means learning to navigate unfamiliar terrain as their influence and responsibilities expand.

Introduction

According to a recent survey co-produced by RIMS and Advisen, nearly two-thirds of risk managers reported that their organizations had a fully or partially implemented ERM program.

The widespread adoption of Enterprise Risk Management (ERM) programs is perhaps the most visible indication that the practice of risk management is undergoing substantive change. According to a recent survey co-produced by RIMS and Advisen, nearly two-thirds of risk managers reported that their organizations had a fully or partially implemented ERM program. In more than half of those organizations, the risk management department was primarily responsible for directing ERM activities.[1]

Related to the growth of ERM is an increasing recognition among senior executives that risk management should not be seen as a bolt-on function and a cost center external to a company's core businesses, but rather as an essential element of business strategy. An Accenture survey of 397 corporate executives found that 85 percent believe that risk has become a driver of competitive advantage for their company, and nearly half believe that corporate risk management will enhance the likelihood of long-term profitable growth.[2]

Driven substantially by technology, globalization, the economy and regulation, some of the most urgent risk management challenges today were barely on the radar screen a decade ago.

Even as organizations learn to perceive risk and risk management in new ways, the underlying risk landscape is rapidly changing. Driven substantially by technology, globalization, the economy and regulation, some of the most urgent risk management challenges today were barely on the radar screen a decade ago. Some of these emerging issues are specific to certain industries, such as responding to changing healthcare delivery models and addressing the risks of heightened financial services regulation, but many others cut across industry boundaries. Growing concerns with supply chain risks, for example, affect organizations ranging from hospitals to information service provides.

Increasingly risk managers are responsible for – or at least involved with – a broader range of risks, and perform in roles that often have greater strategic significance. Often they are interacting with people in senior roles, such as the Chief Risk Officer and the Chief Information Security Officer, which may not even have existed in their organizations only few years ago. As the risk management role continues to evolve, many risk managers have the opportunity to expand their influence and to become essential to achieving the strategic objectives of their organization.

Enterprise Risk Management and the attainment of strategic objectives

Increasingly risk management is viewed as a key input into strategic and operational decision making and planning. Risk management is seen to strengthen an organization's ability to achieve planned targets and business objectives. According to a report from the Committee of Sponsoring Organizations of the Treadway Commission (COSO), "While business leaders know organizations must regularly take risks to enhance stakeholder value, effective organizations recognize strategic advantages in managing risks." [3]

ERM is recognized as a means of making risk management a driver of competitive advantage – to "better connect … risk oversight with the creation and protection of stakeholder value," according to COSO. ERM is not a new concept, but it gained heightened significance and an increased sense of urgency in the wake of the financial crisis and the ensuing recession.

In many organizations a heightened focus on risk management is being driven by the board of directors and C-suite executives. But even companies that may not otherwise be motivated to implement ERM are feeling pressure to take an enterprise-wide approach to risk management by regulators, institutional investors and rating agencies. Credit rating agencies, such as Standard and Poor's, for example, now assess enterprise risk management processes as part of their corporate credit ratings analysis.

Of risk managers surveyed by Advisen, more than half said that the risk management department led the ERM initiative within their organizations.

How risk managers function within an ERM program varies from organization to organization. Of risk managers surveyed by Advisen, more than half said that the risk management department led the ERM initiative within their organizations. This is a significant increase since 2009, when a similar survey was conducted, in which only about a third of risk management departments had direct responsibility for their organization's ERM program. In other organizations, risk managers played a role in ERM programs led by Finance, Internal Audit, Compliance, or other departments.[4]

Risk managers who are fully engaged within ERM programs need to be knowledgeable about categories of risk, such as strategic and operational risk, that traditionally have not been within their domain. They also must acquire knowledge about various organizational functions and effectively coordinate and interact with representatives of treasury, human resources, compliance, information technology and other departments on a range of risk-related issues.

From a practical perspective, although many organizations recognize the importance of ERM, implementing an ERM program can be a challenge. Many companies find it difficult to achieve their ERM goals since barriers to the sharing and understanding of risk information are often institutionalized.

Risk managers who are ERM champions within their organizations not only must become adept at functioning within unfamiliar risk domains, in many cases they must be skilled at gaining cooperation of and consensus among stakeholders within their organizations who may have divergent perspectives and conflicting agendas. Most of all, they need to cultivate the support of senior management, without which a fully implemented and successful ERM is unlikely.

Supply chain risk management

Recent catastrophes such as the Japanese tsunami, Thailand floods, Superstorm Sandy and Icelandic volcanic ash clouds have exposed the vulnerability of modern supply chains. Expansive, global supply chains, combined with just-in-time inventory management, can leave companies highly vulnerable to disruptions caused by natural catastrophes, as well as by political unrest, terrorism, strikes or government actions. The loss of a supplier, or even a supplier of a supplier, can cause a domino effect with profound consequences for individual companies and even entire industries.

Among risk managers responding to a recent Advisen survey, 31 percent said that the risk management department of their organization has a role in managing supply chain risks beyond purchasing insurance.

Supply chain risks are typically thought of as concerns manufacturers, but many other types of businesses are exposed to supply chain disruptions. These include wholesalers, retailers, contractors, hospitals, universities, and even information service providers. For many of these organizations, the loss of even one key supplier can adversely affect revenues and profits. In some cases supply chain disruptions can threaten the continued viability of an organization.

Managing supply chain risks has become a high priority initiative within many organizations. Risk managers are increasingly involved in the process. Among risk managers responding to a recent Advisen survey, 31 percent said that the risk management department of their organization has a role in managing supply chain risks beyond purchasing insurance. Most commonly risk managers provide input into supply chain risk management policies and procedures and evaluate risk profiles of potential new suppliers.[5]

Cyber risk management

For most organizations, it is not a question of "if," but rather "when" they will experience a data breach. Sensitive information may be stolen by malicious hackers who breach an organization's defenses, but it is equally likely that data will be compromised as a result of a lost laptop or smartphone. Additionally, lost or stolen data is only one of a growing number of cyber-related exposures faced by an organization. Increasingly, attacks intended to harm an organization –whether by damaging its reputation or by disrupting its ability to conduct business online – represent a significant threat.

Criminals use evolving leading edge techniques to stay a step ahead of business defenses. Potential attackers include thieves seeking to steal customer data, intellectual property or money; social agitators ("hacktivists") interested in causing a disruption to make social or political point; and cyber-terrorists, which may be sponsored by nation states. Increasingly, organizations recognize that protecting data is not solely an IT function, but a process that demands enterprise-wide participation. Risk managers increasingly are called upon to contribute to this effort.

A 2012 Advisen survey of risk managers found that nearly three-quarters of respondents said that information security risks were a specific risk management focus within their organizations. More than 60 percent of respondents said their organizations had a multi-departmental team or committee to address information security risks, of which nearly 80 percent had representation by the risk management department.[6]

A serious event that undermines a company's reputation can have a material impact on revenues and shareholder value.

Reputation risk and crisis management

In a world where information travels the globe almost instantaneously, bad news can quickly and profoundly affect a company's standing in the market. A serious event that undermines a company's reputation can have a material impact on revenues and shareholder value. Increasingly, companies are aggressively defending their brand and reputation, and in many organizations risk managers are part of the process.

Companies can constantly monitor public sentiment, and should be prepared to respond to negative information. Analytical tools can mine information about a company and its products on blogs, message boards, social media sites, and other online sources. The most damaging events, however, often happen very quickly – a scandal, a data breach, or revelations of a dangerously defective product, for example – requiring immediate damage control. Companies that are prepared to respond quickly almost always fare better than those that are forced to improvise a response under pressure. Risk managers have proven especially valuable in the crisis management planning process.

A growing number of insurance companies are offering crisis management products. These products may compensate a company for various costs associated with responding to an event that can cause reputational harm. The insurer may also provide direct access to service providers such as public relations firms who are ready to react quickly following an event. Often these reputation-related coverages are packaged with other coverages related to events that can result in reputation damage, such as privacy and data breach cyber coverages. They also may be stand-alone policies triggered by specific types of events such as a product recall. Accordingly, the risk manager must be aware of the various sources of brand and reputation risk faced by his or her organization, understand the most effective means of mitigating those risks, and purchase appropriate protection that dovetails with other crisis response procedures that may already be in place.

Terrorism

Terrorism is not a new risk, but it is one that is taking on increased significance as the expiration of the Terrorism Risk Insurance Act (TRIA) looms.

TRIA, which was signed into law in November 2002 and was subsequently extended in 2005 and, under the Terrorism Risk Insurance Program Reauthorization Act, again in 2007.

Risk managers attempting to buy insurance for building projects extending beyond 2014 already report challenges in getting commitments for terrorism coverage for the entire construction period.

Concern is growing that Congress will allow it to expire on December 31, 2014. According to credit rating agency Fitch, "Withdrawal of TRIPRA reinsurance protection without readily available substitute coverage could lead insurers to exclude terrorism from property coverage to manage risk aggregations."[7]

Risk managers attempting to buy insurance for building projects extending beyond 2014 already report challenges in getting commitments for terrorism coverage for the entire construction period. A lack of affordable terrorism coverage could delay, if not scrap, major development plans. Additionally, since banks may require terrorism insurance as a condition of providing lines of credit for real estate projects, real estate owners may find themselves in default of those lines of credit if coverage is unavailable.

It is not clear yet what the insurance industry's response will be if the TRIA backstop disappears. Risk managers are understandably concerned that failure to renew TRIA will affect the cost and availability of insurance coverage, particularly in large urban areas, and many are beginning to evaluate their alternatives. Captives are an alternative, but one that poses many issues. Without the TRIA backstop, the Self-Insurance Institute of America warns that captives "will no longer be viable alternative risk transfer vehicles" for terrorism risk.[8]

With limited risk transfer and risk financing options available, some risk managers are focusing on other strategies to mitigate the impact of a terrorist event. In the chemical industry, for example, a longer term trend has been to employ "Inherently Safer Technologies" (ISTs). This entails replacing dangerous chemicals with safer ones, such as using liquid bleach in place of deadly chlorine to purify water.[9] Such strategies, however, are not universally available to risk managers – relatively little can be done to further reduce the vulnerability of a New York skyscraper, for example. Without assurances that TRIA will be renewed, quantifying terrorism exposure and devising new strategies for financing terrorism risk will become an increasingly urgent part of the risk manager's role in many industries.

Travel risk management

International travel is on the rise. Business people, students and nonprofit volunteers are traveling more, and destinations for overseas assignments and study abroad programs are changing as emerging economies become vital engines of global economic growth. Corporations, universities and nonprofit organizations all recognize their obligations to address the health and safety issues of foreign travelers.

Increasingly risk management departments are being tasked with structuring comprehensive programs that provide not only high quality healthcare coverage wherever travelers or international assignees may become sick or injured, but also an array of other services to assure their safety and comfort.

What once was a human resources function is now becoming the responsibility of the risk management department in many organizations. Previously, organizations may have had a travel risk program that consisted only of an accidental death and dismemberment (AD&D) policy. Increasingly risk management departments are being tasked with structuring comprehensive programs that provide not only high quality healthcare coverage wherever travelers or international assignees may become sick or injured, but also an array of other services to assure their safety and comfort. These include travel alerts, safety training and emergency evacuations in the event of political unrest or natural catastrophes.

The growing involvement of risk managers in this area parallels the increasing breadth and sophistication of programs now offered by a number of large property & casualty insurers. These programs typically provide bundled protection that incorporates insurance and partnerships with global security and intelligence organizations.

Data and analytics

Predictive analytics is not new, but in recent years the concept has been enthusiastically embraced by the insurance industry where it is transforming risk selection, pricing, marketing, and claims management at many companies. Many of the same tools that benefit carriers can provide valuable insights to risk managers, and a growing number of risk management departments are using data and analytics in innovative new ways to quantify exposures, analyze risk management alternatives, improve claim outcomes on self-insured risks and to provide a strong analytical foundation for discussions with underwriters. Many risk managers also have found that analytical tools provide a strong basis for communicating risk factors and their potential impacts to the board of directors and the C-suite. An understanding of predictive analytics increasingly is an important skill for risk managers.

One of the most commonly used analytical tools is the catastrophe model. In a recent Advisen survey or risk managers, in response to the question “Does the risk management department use cat models (itself, through a broker, or through a consultant) to assess the organization’s exposure?” 73 percent responded yes.[10] While risk managers do not typically license and use these models themselves, they nonetheless need to understand the output and how to incorporate it into risk management and insurance purchasing decisions.

Risk management is increasingly recognized as essential to an organization's success, and risk managers are often wielding greater influence on strategic decisions.

Conclusion

Management of individual hazard risks historically was viewed by many organizations as an ancillary operational function, but the global financial crisis and other recent developments such as the Tohoku earthquake and tsunami have highlighted interdependencies within organizations and a need for a more coordinated, comprehensive approach to risk management. Risk management is increasingly recognized as essential to an organization's success, and risk managers are often wielding greater influence on strategic decisions.

The evolving role of the risk manager also is being driven by a rapidly changing threat landscapes. Some risks that were barely on the radar screen only a few years ago, such as cyber terrorism, now represent significant exposures to many organizations. Insurance coverage may be available for some emerging risks, but in many cases risk managers are being called upon to devise innovative solutions for increasingly complex risk challenges.

As a consequence of ERM and their involvement in diverse planning and management settings, and the need to stay a step ahead of emerging risks, risk managers are now challenged to conceptualize their role more broadly. They also are challenged to expand their skills and knowledge, and make continuous learning integral to their role. ■

NOTES:

1 "Budget woes may significantly impact EEOC - but should employers worry too?" Seyfarth Shaw

2 2013 RIMS Enterprise Risk Management (ERM) Survey2 "Accenture Study Shows Risk Management Gains Seat at CEO Table, Driving Competitive Advantage despite Persistent Challenges," Accenture http://newsroom.accenture.com/news/accenture-study-shows-risk-management-gains-seat-at-ceo-table-driving-competitive-advantage-despite-persistent-challenges.print

3 Effective Enterprise Risk Oversight: The Role of the Board of Directors, 2009, COSO http://www.coso.org/documents/COSOBoardsERM-4pager-FINALRELEASEVERSION82409_001.pdfBoard of Directors, 2009, COSO

4 2013 RIMS Enterprise Risk Management (ERM) Survey

5 The Current State of Property Risk Management and Best Practices

6 Information Security and Cyber Liability Risk Management

7 "Fitch Publishes Report on U.S. Terrorism Reinsurance and TRIA Legislation," Fitch press release http://finance.yahoo.com/news/fitch-publishes-report-u-terrorism-175400919.html

8 "SIIA pushes for TRIA extension," Captive Insurance Times http://www.captiveinsurancetimes.com/captiveinsurancenews/article.php?article_id=2957

9 "Targets for Terrorists: Chemical Facilities, Council on Foreign Relations," http://www.cfr.org/united-states/targets-terrorists-chemical-facilities/p12207#p7

10 The Current State of Property Risk Management and Best Practices