Building Buy-In: Overcoming the #1 Obstacle to Effective ERM

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Symptoms of lack of buy-in

- ERM not adopted across all business segments
- Lack of inclusion of all risk sources
- Inability of ERM to inform routine business decisions
- Business performance analytics exclude ERM metrics
- Infrequent, limited, and/or waning interest in ERM at board meetings

Causes: Suboptimal elements of ERM program

- ERM framework
- Risk identification
- Risk quantification
- Risk decision making
- Risk governance

ERM framework: Define risk holistically

- Often, risk is defined only as extreme capital decrease
  → Disconnect with strategic plan, incentives, and decision making
- Better to define risk as:
  - Event causing deviation from strategic plan CFs
    - Links to strategic plan (also an ORSA requirement) and incentives → buy-in
    - Captures all impacts
  - Both upside and downside volatility (full range of scenarios)
    - Supports decision making (also an ORSA requirement) with risk-reward information
- Case study:
  - All roads lead to/from the Strategic Plan
  - Requires a consensus understanding of what's included in the strategy

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Risk identification: Broad/diverse inclusion

- Often, QRA participation is limited
  → Incomplete key risk list / poorer risk culture / lack of buy-in
- Better if enterprise-wide (corporate and businesses) and mix of levels (executives, lieutenants, mid-level-leaders)
  - Captures all types of risk (ORSA req.): strategic, operational, financial
  - Enhances risk culture and buy-in
- Case study:
  - Engagement strategy – executive staff, SME's, members of the Board
  - Sustained engagement in 2nd year cycle – not a one-time event
  - Broad range of disciplines involved and risk sources identified
  - Demonstrates corporate commitment and executive buy-in

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Risk identification: Guided QRA interviews

	Templates	Guided Interviews
Relationships	Damaged: Impersonal, delegated assignment	Enhanced: Respectful, collaborative effort
Level of effort	Inconsistent	Consistent
Quality	Low; written guidance often unread or misunderstood	High; interactive live Socratic guidance

- Case study:
  - No replacement for face-to-face interaction (clarity, relationships, trust)
  - Seek/engage ERM expertise to set foundation; get it right from the start
  - Consistent messaging, vocabulary, granularity
  - Safe environment to provide estimates

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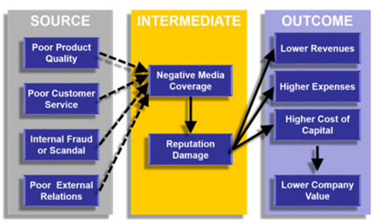
Risk identification: Define risk consistently by source

- Risks often defined by outcome or intermediate outcome
  - → Lack of context → participants scoring different sources → unusable results
  - → Incomplete risk scenario → Misestimating impact
- Critical to define risks consistently by source
  - – Consistent scoring
  - – Complete scenarios → more accurate impact assessments

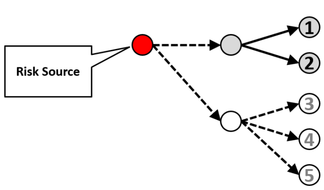
Define risk consistently by source for proper context



Case study:

- Clarifies what "is not" a risk – critical element to risk alignment
- Supports risk culture formation, evolution, education

Define risk consistently by source for complete scenarios and more accurate impact assessments



Case study:

- Creates holistic real-world risk scenarios, not unrealistic stress tests

Risk quantification: Value-based risk scenarios

- Capital-centric and other extreme downside-only scenarios fail to generate buy-in → not connected to day-to-day concerns of the business
- Value-based approach is engaging, addressing what business care about:
  - "What obstacles do we have to achieving Plan?"
  - "How might we exceed Plan?"
  - "How can this process help me achieve my goals?"
  - "How can we make the business case for things we know need to be done?"
- Case study: Know the questions your leaders are asking – show how the framework answers:
  - How much capital do I need?
  - Can we model this?
  - What is our overall risk-reward profile? How does it vary by business segment?
  - Which business segments are contributing the most value? The most risk?

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Risk quantification: Practical ERM models

	Complex	Practical
Model risk	High	Low
Response time	Slow	Fast
Transparency	Low	High

- Practical models → buy-in with decision makers
- Case study:
  - Socialize results – be transparent; people will mistrust the "black box"
  - Demonstrate power of just-in-time "what-if" modeling – nimble, relevant
  - Practical – a model tailored to your business that aggregates results in a way that is meaningful to leadership decision-making

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Risk quantification: Deterministic risk scenarios

- Stochastic scenarios often directly input into ERM model (article)
- Better to develop deterministic scenarios:
  - More robust; helps interviewees think each scenario all way through
    - Case study: The scenarios resonate with the players; ownership encourages buy-in
  - More accurate; fewer errors/bias via vertical/horizontal documentation/sharing
    - Case study: The Interview process includes iterative validation feedback with the owner
  - Enhance risk culture; transparent (one-pagers) → buy-in → decision making
    - Case study: Results are quickly and easily consumed by owners
  - Leverages all info, including stochastic; extracts/leverages internal knowledge/judgment
    - Case study: SMEs are critical – engage the most relevant thought leaders
  - More dynamic (ORSA requirement), avoiding dependency on static indexes
    - Case study: Easily update scenarios

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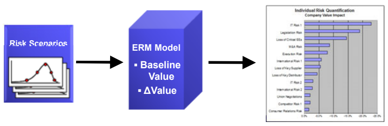
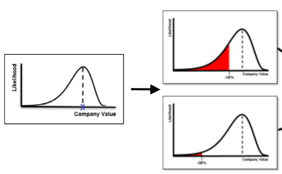
Risk quantification: Quantify all risks

- Often, only financial risks quantified
  - Decisions related to strategy and operations not supported
  - Quantifying enterprise risk exposure not possible
- Value-based approach quantifies all risks consistently



Risk quantification: Quantify enterprise risk exposure

- Often, enterprise risk exposure is not a fully quantitative expression including all volatility
- Value-based approach allows full quantitative expression



ILLUSTRATIVE EXAMPLE

"Pain Point"	Likelihood
ΔValue ≤ -10%	25%
ΔValue ≤ -30%	4%

Risk quantification: Quantify enterprise risk exposure (cont.)

ILLUSTRATIVE EXAMPLE

Pain Point	Likelihood
Decrease in company value of >10%	25%
RBC ratio < Target % over Plan period	2.3%
Falling short of Plan revenue growth by >200bps	11%

Risk decision making: Defining risk appetite quantitatively

- Many risk appetite statements lack a hard quantitative expression of the limit on enterprise risk exposure
  - Not representative of full volatility
  - Not actionable
- Value-based approach allows quantitative expression that can be directly compared to enterprise risk exposure
- Case study:
  - Draft it in pencil – provide the flexibility for leaders to “live with it” for a while and ultimately rationalize their understanding of the measure and their tolerance

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Risk decision making: Providing risk-return tradeoffs

- Many ERM programs provide just extreme downside or capital impact of a potential decision → business decisions cannot be made without the full range of risk (downside) and return (upside) info
- Value-based approach provides robust risk-return info for any decision – strategic planning, strategic, tactical, transactions, mitigation
  - Δ return = Δ baseline strategic plan projection and key metrics
  - Δ risk = Δ enterprise risk exposure (and sub-enterprise exposures)
- Case study:
  - Gain consensus around what’s in strategic plan – don’t underestimate the value

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Risk governance: Understandable board reports

- Often, ERM reports to boards are abstract (e.g., disconnect from strategy) and incomplete (not all risks included or quantified)
- Value-based approach provides clarity, practicality, and strategy connection that engages and properly informs the board

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