



# Specimen coursework assignment

## 992 – Risk management in insurance

The following is a specimen coursework assignment question and answer. It provides a guide as to the style and format of coursework questions that will be asked and indicates the depth and breadth of answers sought by markers. The answer given is not intended to be the definitive answer; well reasoned alternative views will also gain good marks.

Before commencing work on an actual coursework assignment, you need to fully familiarise yourself with the following documents:

- *Coursework assessment guidelines and instructions;*
- *How to approach coursework assignments;*
- *Explaining your results notification.*

Coursework assignments involve the application of knowledge to work-related questions. They require you to explore issues in the workplace relevant to the unit for which you have enrolled.

## **Coursework submission rules and important notes**

Before commencing on, or submitting, your coursework assignment it is essential that you fully familiarise yourself with the content of *Coursework assessment guidelines and instructions*. This includes the following information:

- The maximum word limit for coursework assignments is 3,200 words.
- Arial font and size 11 to be used in your answers.
- Important rules relating to referencing all sources including the study text, regulations and citing statute and case law.
- Penalties for contravention of the rules relating to plagiarism and collaboration.
- Deadline for submission of coursework answers.
- There are 80 marks available per assignment. You must obtain a minimum of 40 marks (50%) per assignment to achieve a pass.
- The coursework marking criteria applied by markers to submitted answers.
- Do not include your name or CII PIN anywhere in your answers.

## **Top tips for answering coursework assignments**

- Read the assignments carefully and ensure you answer all parts of the assignments.
- Ensure that each answer includes a relevant context, regardless of the country or countries to which it refers.
- You must include a context in each answer. You may use the same context for each of the three answers.
- For assignments relating to regulation and law, knowledge of the UK regulatory framework is appropriate. However, marks can be awarded for non-UK examples if they are more relevant to your context.
- There is no minimum word requirement, but an answer with fewer than 2,800 words may be insufficiently comprehensive.

## Assignment

A large general insurer has recruited you to the newly established role of Group Head of Risk Management.

Currently the insurer does not have a coherent Enterprise Risk Management (ERM) framework in place. The insurer's risks are managed within each individual department, with each department independently implementing their own risk management solutions. This has made group-level reporting and oversight very difficult.

- Design and justify a suitable ERM framework taking into account the range of available risk management standards.
- Analyse the potential costs and benefits that may be associated with the implementation of your proposed design.

### To be completed before submission:

<b>Word count:</b>	3,340
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### Start typing your answer here:

#### INTRODUCTION

As the new Group Head of Risk Management for a large general insurer with no coherent Enterprise Risk Management (ERM) framework, I have been tasked to:

- Design and justify an ERM framework
- Ensure the framework takes account of available risk management standards
- Analyse the potential associated costs and benefits associated with the ERM implementation

Risk management is an increasingly fundamental part of the operation of any business. Indeed, insurance decisions are seen as just a part of a company's overall risk management strategy. What was once considered a practice is now very much seen as a profession and risk management professionals are increasingly required to obtain formal qualifications.

The Federation of European Risk Management Associations (FERMA) formally launched its programme of European Certification for professional risk managers in October 2015 (*FERMA Forum 2015*). At the opening of the 2015 Forum, Mario Greco, CEO of Italy's multi-national insurance group Generali, stated that in an ever more complex world, risk management has become a core business function:

*"Managing risks should influence everything from strategic decision-making to day-to-day interaction with customers, regulators or suppliers. Good risk management is not a burning platform but the eternal flame."*

Talking about the role of companies like Generali, he added: *"Industry should play its part in providing new ways of approaching problems as well as innovative solutions to them"*.

Further evidence of the increasing profile of risk management in organisations, and particularly those in the insurance sector (which many now consider as the insurance and risk management sector), is in the way that the profile of the Risk Manager, often a board level appointment, has increased. The Insurance Manager, if there is such a role anymore, will likely report into the Risk Manager. In addition, all of the larger insurance brokers have specialist risk management teams who offer risk management services, to support their clients. For example, Willis Towers Watson offers the following:

*"Willis has extensive experience in developing solutions to help you manage your business risks.*

*Our expertise covers the full spectrum of business risk from operations through to strategic issues. Our typical assignments include helping clients comply with corporate governance requirements, embedding risk management into business planning, reducing the cost of risk and developing risk implementation processes and systems.*

*Areas where we have provided solutions in the past include:*

- *business continuity planning*
- *risk profiling*
- *strategic decision risk analysis*
- *cost benefit analysis*
- *managed risk culture*
- *strategic risk management integration*
- *optimizing risk management IT solutions*
- *deployment of risk self-assessment*
- *implementation of CRSA (Control Risk Self-Assessment)*
- *risk management costs tracking"*

These services may be offered on a standalone basis or to existing clients in order to reduce the transferable insurance premium spend by reducing risk. (www.willistowerswatson)

ERM has emerged as a key business tool over the last few years.

According to Phil Griffiths (2012) in his paper entitled 'Enterprise Risk Management – The Key to Business Success':

*"Risk Management has become a vital ingredient in the entrepreneurial culture and is needed to develop, expand and improve business performance. There is clear evidence that good risk management adds considerable value to the business."*

Currently, the management of risk at my insurance company is dealt with on a departmental basis. The key benefit of implementing an ERM framework will be to provide a central focus. There are a number of clear steps which must be followed in designing the framework and these will be discussed below.

It is assumed that the company has its headquarters in the UK, but conducts business on an international basis.

## **DEFINITION OF ERM**

The Committee of Sponsoring Organisations, (COSO), a voluntary private-sector organisation in the United States, dedicated to improving the quality of financial reporting, published an Enterprise Risk Management Integrated Framework in September 2004 which defines ERM as:

*"...a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of the entity's objectives."*

According to KPMG (November 2001) in a report entitled 'Enterprise Risk Management – An emerging model for building shareholder value':

*"Enterprise wide means the removal of traditional functional, divisional, departmental or cultural barriers."*

They also make the point that risk management must now extend to a wide variety of strategic, operational, reputational, regulatory and information risks and that ERM can provide organisations with a new competitive advantage.

According to COSO, their definition reflects certain fundamental concepts:

- A process, ongoing and flowing through an entity
- Effected by people at every level of an organisation
- Applied in strategy setting
- Applied across the enterprise
- Designed to identify potential events
- Able to provide reasonable assurance to managers and directors
- Geared to achievement of objectives

The emphasis on the fact that ERM is an ongoing process will be highlighted below in more detail.

## AVAILABLE RISK MANAGEMENT STANDARDS

In order to standardise the approach taken by organisations, various risk management standards have been promulgated by risk management bodies and national/international working groups. Three key risk management standards that could be used:

- The International Organisation for Standardisation risk management standard ISO 31000, as published in 2009
- COSO 'Enterprise Risk Management – Integrated Framework'
- The Institute of Risk Management (IRM) Standard (2002)

For my organisation which is based in the UK, ISO 31000 is the most appropriate standard because, according to Risk Management London: CII Study Text 992; this standard sets the risk management framework in the context of the firm. Therefore this is a true ERM approach as opposed to a more risk management specific approach and it is an internationally recognised standard, which can be used for our international operations.

This standard suggests that the strategic context, the organisational context and the risk management context must **all** be considered in order for risk assessment to be properly analysed.

ISO 31000 includes the essential steps in the implementation and ongoing support of the risk management process. The first component of the ISO 31000 framework is 'mandate and commitment' by the Board and is followed by the design of the framework, implementation of risk management, monitoring and reviewing the framework and improving the framework.

## ELEMENTS OF ERM FRAMEWORK

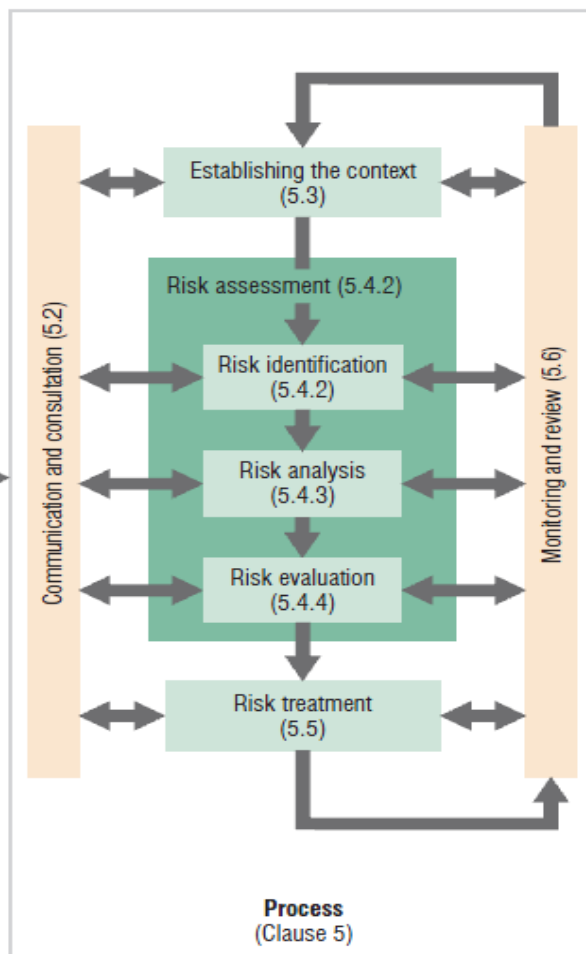
ISO 31000 describes the components of a risk management implementation framework as follows:

- Design Framework
- Implement Risk Management

- Monitor and Review Framework
- Improve Framework

The diagram below illustrates the cyclical approach to ERM framework design proposed by ISO 31000:

**Diagram 1**



Each of these stages will be discussed below. However, before the process begins, it is essential to ensure there is agreement at board level, with the achievement of a mandate and commitment at that level. The key here is to ensure that the organisation's strategic goals are included at the design stage. The justification for obtaining board level approval is

to ensure that there is sufficient board level support for ERM. This should ensure that ERM is embedded from the top down, that ERM is properly communicated and that the costs associated with implementing the framework are authorised.

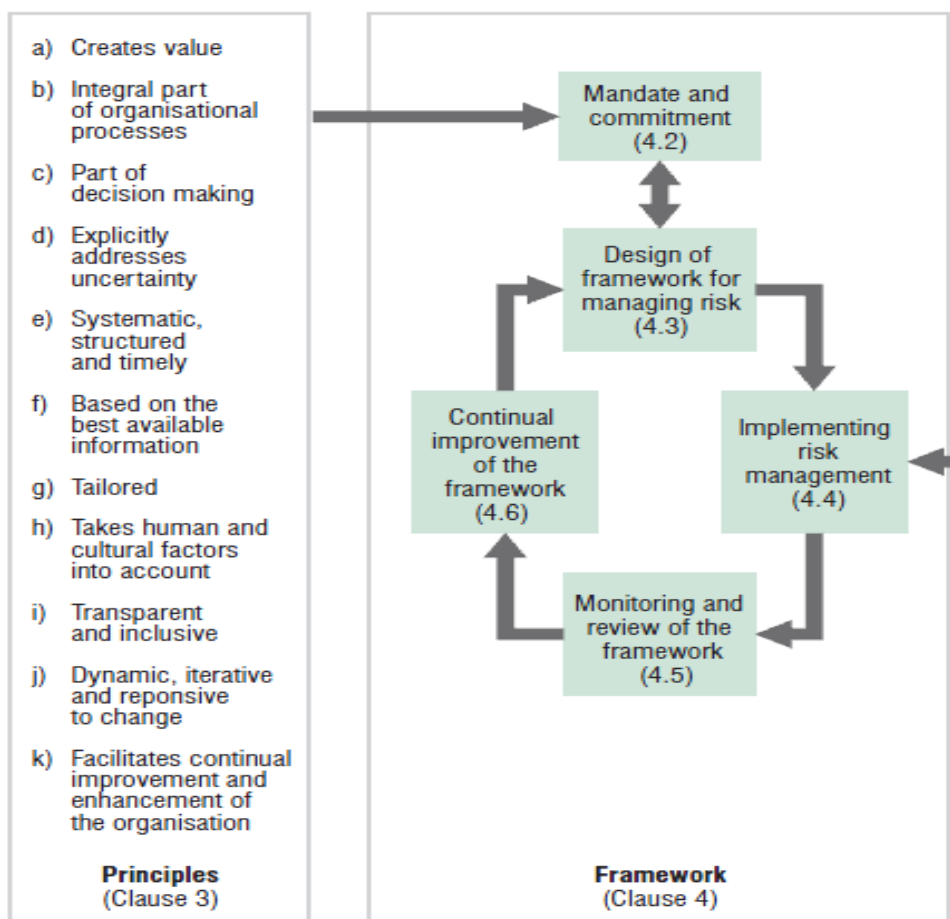
According to the IRM (2010) in a paper entitled ‘A structured approach to Enterprise Risk Management (ERM) and the requirements of ISO 31000’,

*“ISO 31000 describes a framework for implementing risk management, rather than a framework for supporting the risk management process.”*

This means that my risk management framework will provide the high level detail of how the framework can support risk management in my organisation, rather than a detailed description of the risk management process.

I will now consider the four components of a risk management implementation framework as illustrated in the diagram below:

**Diagram 2**



## a) Design of Framework

The first step is to design the risk architecture, where the roles and responsibilities, communication and risk reporting lines are established.



In order to manage our risks properly, we need to ensure that everyone in the organisation is clear on their own role in relation to risk management. Where an individual has a particular responsibility for managing risk, this must also be made clear to them. In a large organisation, my role as Head of Group Risk Management includes advising the board on risk strategy and attending meetings to advise on risk issues. It would also be sensible to

appoint a senior risk manager and other risk managers as appropriate to work together in the management of our risks. Risk analysts could also be appointed to manage risk registers in each department. Many of these roles may already exist, but now require coordination.

All lines of communication must be understood and conveyed so there is no doubt as to how risk information can be shared between all parts of the organisation. This will mean the establishment of a company-wide risk information system, so that the risk information can be managed in a unified and consistent way.

Finally, there must be clarity in relation to the reporting structure so that all the key roles are understood.

The organisation's risk strategy, its appetite, attitudes and philosophy must be defined and captured in the Risk Management Policy. The Policy could list details that would assist in the underwriting of risks and will provide information on what types of risk could be targeted by the insurer and which should be avoided. It would also include high level details of the organisation's attitude to risk in relation to its investment portfolio. The risk appetite, risk tolerance, risk aversion and risk capacity must be clearly established. For example, the important issues for our organisation would be reputation, regulatory risk, capital adequacy and ethics.

Risk protocols should also be established at this stage, taking the form of risk guidelines for the organisation and include the rules and procedures, as well as specifying the risk management methodologies, tools and techniques that might be used.

The justification for designing the framework properly before any form of risk management is implemented is quite obvious. Unless all staff are aware of their roles and responsibilities and how to communicate in terms of risks, the risk management process will be impossible to manage effectively. Consistency will be achieved through a more standardised approach.

## **(b) Implement Risk Management**

The implementation of a risk management process systematically applies the management policies, procedures and practices already established in the first step.

The process is monitored and reviewed regularly and communicated and consulted on. As can be seen, central to the process is risk assessment in terms of identification, analysis and evaluation.

As has been identified above in diagram 1 on the ERM process, the first step is to **Establish the Context**, by defining the external and internal parameters that the organisation must consider when managing risk.

The External Context can be seen as our relationship with our environment, the economy, our clients, brokers and all stakeholders. To fully understand it we could undertake a Political, Economic, Social and Technological (PEST) or Strengths, Weaknesses,

Opportunities and Threats (SWOT) analysis. An example would be by being clear on our optimum sales strategy.

The internal context includes our overall objectives, for example, do we want to increase market share and, if so, by how much?

The Risk Management Context identifies the risk categories of most relevance to our organisation, both accounting and non-accounting key risk indicators (for example IT down time).

**Risk Treatment** is effectively a risk modification process and involves selecting and implementing one or more treatment options.

The justification for this step is that it supports decision making, is tailored to the organisation's needs and because it is continually reviewed it is dynamic, iterative and responsive to change.

The **Risk Assessment** process involves identifying each risk in the organisation, by use of a risk register for example. The risks are then analysed in terms of severity, impact and likelihood, by way of probable distributions of outcomes. Analysis techniques include qualitative as well as quantitative methods. Finally all risks are evaluated in terms of integration of the risks, whereby risks are aggregated and then prioritised so that decisions can be made for their treatment. It is the role of senior management to prioritise each risk and allocate resources accordingly.

### (c) Monitoring and Review of the Framework

ISO 31000 recognises the importance of monitoring and feedback by way of two mechanisms:

- Monitoring and review of performance
- Communication and consultation

By monitoring the process and reviewing accordingly, we as a company ensure we are monitoring risk performance and benchmarking against our strategy and goals and, most importantly, we are learning from our experiences.

As can be seen from diagram1 on the risk management process, communication and consultation are part of the process, but it is also a key part of the supporting framework.

In addition, by monitoring this framework, we could identify new risks. Examples of new risks include a competitor aggressively targeting our traditional risk areas for less premium, emerging business models and recession risks.

Further justification for monitoring is to ensure that the framework is still relevant. This is important as we are continually evolving, growing and changing. The framework should reflect this.

### (d) Continual Improvement of the Framework

It is important that framework design is considered as an ongoing, ever evolving process. Through our monitoring of the risk management process, we will be aware if changes need to be made. Also, our strategy and attitude to risk, the risk architecture, might change. The framework can always be improved by amending our protocols, methods of communication or the risk management process itself.

The justification for doing this is that we should always strive to manage our risks better, to avoid the possibility of financial or reputational damage. We can improve the framework by identifying what our competitors do well and avoid repeating our mistakes.

### COSTS AND BENEFITS

There are a number of costs and benefits associated with the implementation of an ERM. Paul Klumpes, in an article in *The Actuary (March 2012)*, makes the point that:

*“...UK Insurance firms focusing on accounting rates of return (such as return on equity ROE) tend to use different approaches to managing risk for performance reporting than for management planning and control.”*

A high quality ERM delivers many benefits beyond simply monitoring performance, in fact it could be used to drive all future plans and provide a competitive advantage. However, there are associated costs. I have considered these costs and benefits specifically in relation to my employer, a large general insurer.

An analysis of the costs and benefits of adopting an ERM framework will now be considered.

The Potential Costs of ERM	
Cost	Analysis
1. Requires management support	The board need to agree to implement ERM, this may take time and strong leadership is required.

	Risks will need to be owned by individuals and this also takes time and associated cost.
2. Set up challenges	High set up costs in terms of time, systems, additional responsibilities, demonstrating the benefits/value of ERM. In particular risk identification, prioritisation, reporting and formulating the risk appetite and risk management policy.
3. Defining a common risk language	Each employee will need to understand the new terminology involved and this will take time and associated cost.
4. Sourcing appropriate data may be hard	New systems may need to be purchased and new staff employed or trained. Time spent on ERM is time away from core roles.
5. Additional training as ERM may require significant changes to the way people work	Due to the fact that ERM involves all staff, additional training will be required at a monetary cost and in terms of staff and management time.
6. Must ensure ERM integrates with and complements the existing operation of the business	Full integration will involve inter-departmental co-ordination at all levels, both operational and managerial. This takes time and will involve financial outlay.
7. Reporting must be timely	Management information and new reports must be established to support decision making. This may take time away from staff at the operational level and there may be an associated IT cost..
8. Over reliance on quantitative measures	Too much focus on figures, which are the most simple to measure may cause organisation to lose sight of wider risk issues.
9. Group wide risk statements may be overly simplistic	The organisation is diverse and a one size fits all risk statement may not be appropriate.
10. Rules based compliance mentality	Due to complexity of the organisation, a rules based compliance system may not fully appreciate the reality of the situation.
11. Staff morale	Currently each department is managing its own risks, implementation of ERM may cause upset at the operational level and additional strain.

12. Risk Focus	A focus on process may divert attention from less obvious, but potentially more serious Risks.
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<b>The Potential Benefits of ERM</b>	
<b>Benefits</b>	<b>Analysis</b>
1. Helps organisation to make structural/strategic changes	ERM helps management create risk awareness to enhance organisational effectiveness, establishing strategy and aligning strategy with corporate culture.
2. Used to identify specific action steps	Leads to enhanced performance and risk Optimisation.
3. Helps organisation to shift its focus	From day to day crisis response to the evaluation of risk in business strategy, enhancing decision making.
4. Reduce unacceptable performance variability	Provides a method of evaluating the likelihood and impact of major events and developing responses to prevent them occurring or controlling their impact, leading to more consistent performance.
5. Align and integrate varying views of risk management	At present risk management is being dealt within each department. ERM provides an organisation wide approach that is both more cost effective as it eliminates duplication and leads to an integrated response to risk. It encompasses all areas of organisational exposure to risk. It also allows us to consider aggregation of risks.
6. Build confidence of stakeholders	If regulators, ratings agencies, potential investors, staff and customers see that the organisation understands and manages risk, enabling them to make an informed and positive assessment.
7. Enhance Corporate Governance	Good governance and ERM are linked. ERM can strengthen board oversight whilst good governance sets the tone for understanding risk.
8. Successfully respond to a changing business environment	As the business environment changes at an increasing pace, we need to be better equipped to identify and prioritise.

9. Encourages longer term outlook	Planning ahead is essential to the process and it is important that all involved recognise that the results may not be seen in the short term.
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## CONCLUSION

Designing an ERM framework using ISO 31000 should not be seen as an isolated, one off, exercise. Instead ERM is a continually evolving and changing process. The risk management process needs to be monitored, assessed and then the identified improvements adopted accordingly. Furthermore, it is essential that senior management support the process and that all staff are engaged in adopting the new practices and taking on additional responsibility.

There are challenges and costs associated with the implementation of the framework. These should be understood and addressed during the design phase to ensure that funds are allocated accordingly, senior management and staff are briefed and expectations are managed.

According to the Casualty Actuarial Society (*May 2003*) in its report 'Overview of Enterprise Risk Management':

*"...there will always remain risks that are not easily quantifiable. These are risks that are not well defined, unpredictable as to frequency, amount or location, risks subject to manipulation and human intervention and newer risks."*

They go on to provide examples of how insurance companies have used ERM:

- Reconsider distribution strategy
- Assessment of relative levels of economic capital
- Asset allocation strategy
- Improve Product design features
- Viability of current dividend strategy

It is important that we as an insurance company take every step to ensure we recognise all types of risk, minimise their impact, or even see them as new opportunities. ERM will help us to focus our efforts at collective risk management and for us all to take ownership. However, ERM does have its costs and limitations and these must also be understood.

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## Glossary of key words

### Analyse

Find the relevant facts and examine these in depth. Examine the relationship between various facts and make conclusions or recommendations.

### Describe

Give an account in words of (someone or something) including all relevant, characteristics, qualities or events.

### Discuss

To consider something in detail; examining the different ideas and opinions about something, for example to weigh up alternative views.

### Explain

To make something clear and easy to understand with reasoning and/or justification.

### Identify

Recognise and name.

### Justify

Support an argument or conclusion. Prove or show grounds for a decision.

### Recommend with reasons

Provide reasons in favour.

### State

Express main points in brief, clear form.