FERMA risk management benchmarking survey 2008

Keys to understanding the diversity of risk management practices in Europe

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Introduction

"The FERMA Benchmarking Survey has been one of FERMA's most important projects since 2000. Again this year, FERMA has put a lot of effort into encouraging participation and improving the contents of the questionnaire and the quality of data restitution and analysis. The report provides us with good quality information to compare the evolution of our jobs in Europe."

Marie-Gemma Dequae, President of FERMA

"As our global economy continues to suffer aftershocks of the subprime crisis, most companies want to assess the knock-on impact on their business of the wider economic downturn. In such a troubled period, the risk management process must demonstrate its added value by embracing a broader view of strategic and external risks without losing sight of its traditional objectives such as minimising operational surprises and reducing costs.

The Ernst & Young team involved in this survey is convinced that this document can help companies challenge themselves on their risk management practices in order to (re)define their risk management vision and adequate path for the future."

Dominique Pageaud, Partner, Ernst & Young

"The insurance market remains a key provider of financial protection for industry and services. Risk transfer is risk managers' preferred tool to manage the ever developing risks of their companies. Prevention of risk is definitely the favoured approach to limit exposure and secure the image and brand of companies. Demand from buyers for a better quality of services from the main actors in the insurance chain, carriers and brokers, is ever stronger in response to the pressure of new regulation, internal and external audit, and controls within companies.

In a 2008 environment of international financial uncertainty, carriers have to "redefine their standards" to offer to risk managers more security in their risk transfer process, more maturity and reliability."

Jean-Paul Rignault – CEO, AXA Corporate Solutions

Key findings

The fourth biennial benchmarking survey conducted by the Federation of European Risk Management Associations (FERMA) in collaboration with AXA Corporate Solutions and Ernst & Young shows both an overall increase in maturity and a wide diversity in practices across the 555 respondents representing companies across the continent.

Key lessons include:

- **Internal and external drivers are converging** to raise the profile of risk management. Companies develop their risk management strategies for their own benefit, to secure the fundamentals of their business models, safeguard key assets and minimise operational surprises or reduce the cost of risk. Embedded risk management gives executive teams confidence in the appropriate running of their operations, and in meeting legal and regulatory requirements.
- **Communicating on risk has become a core corporate skill.** The ability to present a risk management framework and practices convincingly is an increasingly powerful way to build trust and corporate credibility in the eyes of external parties such as shareholders and many other stakeholders. Recent developments have shown that credit rating agencies are now adding their weight to the list.
- **European companies have matured,** in that a vast majority has decided how to tackle risk management. Established policies, charters, defined processes are now the norm rather than the exception. Respondents to the survey, however, admit to a potential **"execution gap"**. A much smaller proportion of companies is able to state that their risk management processes are actually embedded in operations. Many more see it as work in progress…
- Respondents believe that **exposures are continuing to evolve.** They think earlier efforts have resulted in a continuing reduction in operational risks. On the other hand, they expect exposures related to the environment and sustainable development to increase in importance in the next two years. Legal risks, including legislation, policy and national and international regulation, are also seen as growing. Commercial risks, such as market pressure and competition, are regarded as second only to operational risks in importance today and likely to increase.
- The survey reveals **a wide diversity of risk management practices,** allowing the identification of five "families" of companies demonstrating different behaviours and attributes in the way they approach risk. The least sophisticated are the "happy-go-lucky" companies at the inception of their engagement with risk management and the "fire-fighters" reacting to events. Then, there are three classes of organisations with more mature risk management: the "rules-driven" organisations operating in heavily regulated environments, "self-motivated" companies seeking performance return on risk management investment and "balanced and sophisticated" companies responding both to regulatory and performance drivers.
- As far as **risk financing** is concerned, corporate buyers are less concerned than previously about the impact of premium increases and continue to look to their insurers for solid services: policies, claims management, international programmes and capacity. When it comes to pricing, the consensus is that rates have stabilised for most classes and that some increases are likely in the medium term, particularly for environment-related risks and directors' and officers' and other liability risks.

The Federation of European Risk Management Associations (FERMA) in collaboration with AXA Corporate Solutions and Ernst & Young conducted a risk management benchmarking survey of European companies between March and May 2008. This is the fourth such survey, which has taken place every other year since 2002.

The survey, consisting of 30 questions, received 555 replies from more than 16 countries. The highest proportion came from France (22%), the United Kingdom (17%) and the Netherlands (9%), Sweden (8%) and Germany (7%). The rest are from countries spread across Europe, plus 3% from US based organisations.

Half of the organisations represented are industry, 19% are services and 4% government and public service bodies. The companies are mainly large enterprise with international activities, very extensive for some, and 56% are listed on at least one stock exchange. Two-thirds have a turnover of more than €1bn a year and employ more than 5,000 people.

The answers are becoming increasingly representative of Europe's professional risk management community: of the 555 replies, 81% came from risk or insurance managers. The 17 national risk management associations that belong to FERMA have over 4,000 members. Of previous surveys, there were 460 responses in 2006, 269 in 2004 and 49 in 2002.

A positive trend toward increased maturity

The survey revealed continuing progress in risk management fundamentals. More than three-quarters say they have a defined risk management policy and 80% have a defined risk management process.

For European companies, time has come to execute those policies and processes. For instance, corporate level risk assessments are increasingly widespread, rising from 47% in 2004, to 50% in 2006 and 55% in 2008. For 35% of companies, this is supported by an embedded risk management reporting system. While, overall, there is an increase in virtually all risk management activities described as embedded, most risk management practices still display room for improvement for around half of companies.

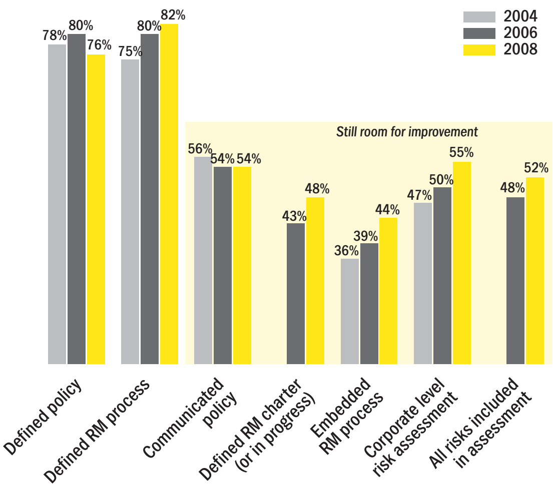
The ability to demonstrate the return on investment on the risk management effort is more than ever important. While compliance with regulatory and legal requirements remain an important driver in the development of risk management, increasingly it is an element of enterprise risk management, rather than a principal objective.

Similarly, good internal practices that are primarily geared at improving the business can provide additional benefits as they can be explained to meet external scrutiny.

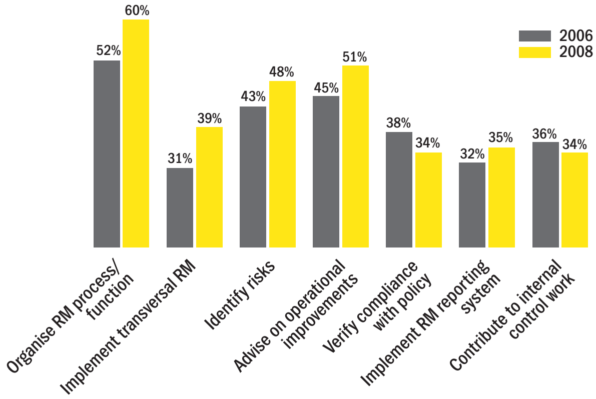
The challenge is for risk management to be truly linked "real time" to core decision-making processes within organisations. Overall, 54% have created links with strategic planning, and among the more sophisticated companies, this proportion rises to more than two-thirds. In a substantial minority, it is also linked to acquisitions and transfers, investments and budgeting.

More than half those responding adopt a comprehensive approach to risk, dealing with all types of risk, ranging from strategic to financial and operational, and 31% deal with all operational risks, whether insurable or not. Minimising operational surprises and losses, nevertheless, remains at the heart of the risk management role. Nearly three-quarters of those responding named this objective as one of their principal missions, as they had in 2006.

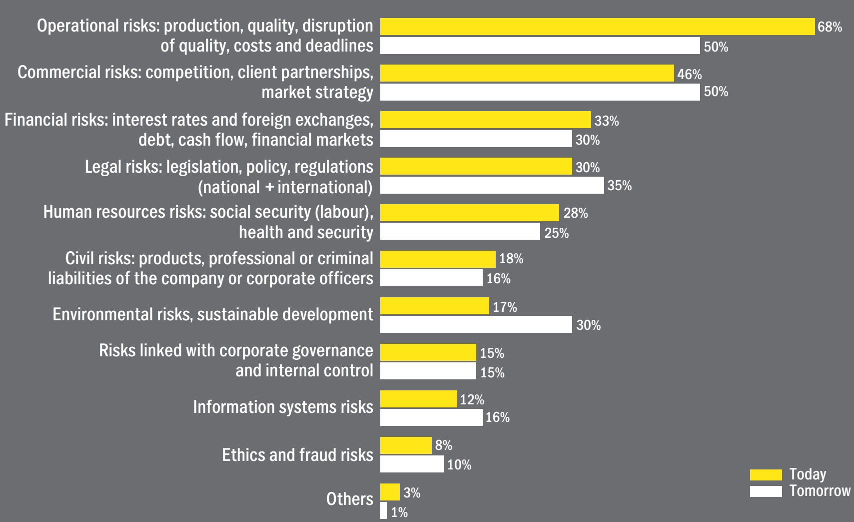
Risk Management policy and practices



Risk Management activities



Most important categories of risk faced by the companies according to Europe's risk and insurance managers



An ever changing risk portfolio

The nature of exposures is ever changing. Optimism about the future is closely linked with confidence in the level of maturity of risk management.

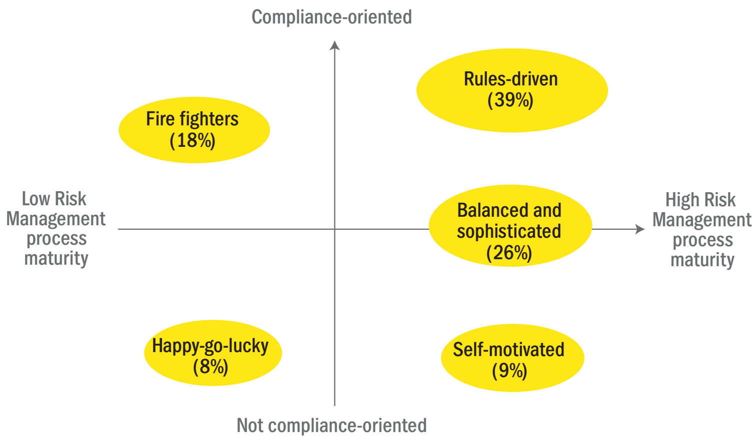
The benefit of investment in risk management shows itself in a continuing belief that the risks over which the organisation has the most control, (operational, human resources, financial and liability risks) will diminish over the next two years.

On the other hand, externally generated exposures are likely to grow. The most pronounced of these are risks related to the environment and sustainable development, but regulatory and legal and commercial risks, such as competition and choice of market strategy are also increasing.

Capturing the diversity of risk management practices: 5 families

The survey has sought to determine meaningful axes to identify representative groupings of risk managers that reflect the disparity of practices in Europe today. These practices reflect the evolution of companies themselves, in which legal and regulatory developments have played an important role. The axes, therefore, show degrees of risk management process maturity and level of compliance orientation. The quality of the connection between risk management and the core decision-making processes varies according to the profiles.

- **Rules-driven** (39%) include a high proportion of companies and organisations in highly regulated sectors, such as financial services, and public bodies. The ability to invest in risk management was a response to external pressures. UK and German organisations are well represented, while Swedish and Italian are under-represented.
- **Balanced and sophisticated** (26%) companies are those who balance their shareholders' interest in performance with compliance objectives. They include rather large firms and financial institutions. A conspicuous characteristic of this group is that 71% are quoted companies.
- **Fire fighters** (18%) are mainly driven by compliance and reaction to adverse events. Their risk management investment is limited. They tend to be smaller and medium sized businesses with a high representation of Italian and Swedish companies. Somewhat surprisingly, half of them are listed.
- **Self-motivated** (9%) companies are responding more to shareholders than regulatory drivers. They are generally privately owned, mid-sized companies in commerce.



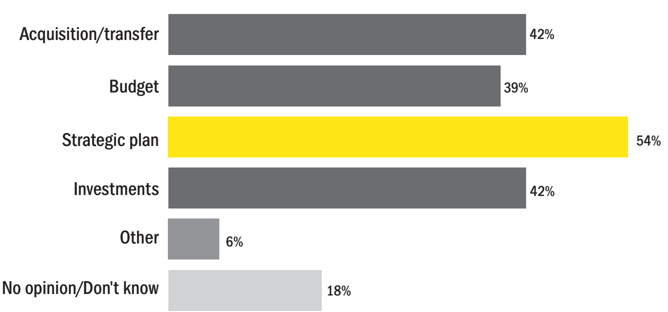
Base: 356 respondents

- **Happy go lucky** (8%) organisations are new to risk management and so likely to be rather unsophisticated. They are mainly smaller companies and some public bodies that had not encountered the need for a risk management investment earlier in their development. It is surprising to find that 60% of them have a stock exchange listing.

It is worth noting that the evolution of an organisation toward higher maturity levels is not necessarily linear. It can belong to several of these families in succession as its approach to risk management matures in response to external conditions as well as its own development.

Early signs of bringing risk management and strategy together

In which area(s) are risk assessment and mapping linked to decision-making?



Risk management helps keep the business out of trouble – and work better. A large part of the value brought by risk management resides in being connected in "real time" with decision-making as companies must often live with the consequences of their decisions over the medium to long term. It is therefore interesting to note that around half (52%) of organisations link risk analysis with strategic planning (52%). A substantial minority of respondents make that link with acquisitions and transfers (42%), investments (42%) and budgets (30%).

Aligning risk appetite and strategy and identifying and managing cross-enterprise risks remained important for nearly half the sample. There was less emphasis in 2008 on measures such as enhancing risk response decisions and linking growth, risk and return.

Unsurprisingly, self-motivated and balanced and sophisticated companies are the best able to feed risk information into key business decisions.

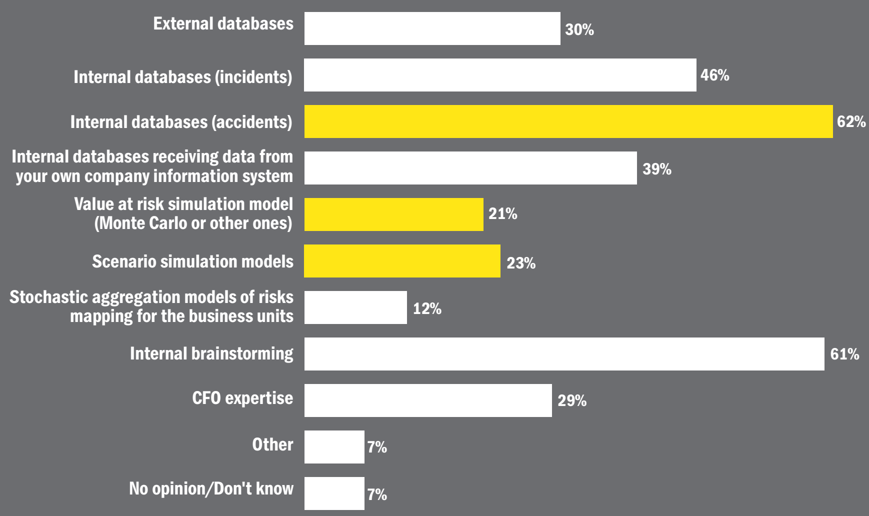
Moving towards more precise risk quantification

Almost all organisations try to measure or quantify some or all of their risks. Half do it on a global corporate level, half for certain categories of risk and 15% for certain activities or geographical areas. The tools used depend on the type of risk. Internal databases and internal brainstorming are most important and nearly two-thirds say they use them. Almost one-quarter, however, do use sophisticated techniques, such as value at risk or scenario simulation models.

In terms of risk management practices, the results are predictable. The balanced and sophisticated and self-motivated use the most sophisticated techniques and the happy-go-lucky and fire fighters the most basic. The balanced and sophisticated group, which includes many financial institutions, makes most use of the widest number and types of tools, including models.

A shift in reporting lines prompts the question whether risk management is becoming more financially oriented. In the current survey, 51% said risk management reports to the chief financial officer or treasurer, compared to 46% in 2006. The CFO is also the principal sponsor of risk management, cited by 39% of the respondents.

In order to measure/quantify your risks, what kind of tools do you use?



Communicating on risk: a core skill to nurture

Communication of risk related information in financial reports is now widespread, but there is room for improvement, with 31% saying they discuss major risks and 24% covering not just major risks but also an assessment of their importance and management, while 18% communicate only about general risks to the sector.

The effectiveness of the communication on risk management policy and actions is generally regarded as reasonable, with one-third (32%) overall rating it satisfactory and 35% mostly satisfactory. Informing shareholders and other stakeholders is seen as a key element in taking risk management beyond compliance.

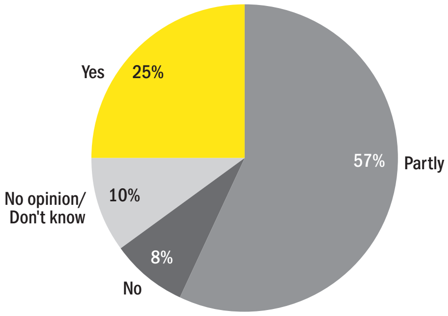
A key lesson is that risk communication can be a true driver of competitive advantage as not all companies can truly convince third parties of the in-depth quality of their risk management. This is particularly true as rating agencies are beginning to raise more questions in this respect.

Again, the various risk management families vary significantly in their ability to communicate on risk. Clearly, "real substance" allows more sophisticated companies to better articulate their message.

	Overall sample	Happy-go-lucky	Fire fighters	Rules-driven	Self-motivated	Balanced and sophisticated
The company communicates satisfactorily to its shareholders and investors on its risk management policy and actions	32%	31%	11%	33%	29%	**54%**
Within the scope of its financial reporting (annual report, reference documents, etc.), communication is provided for major specific risks as well as assessment of their importance and management	24%	14%	6%	27%	13%	**43%**

The future of the insurance cycle

Do you consider that traditional markets are able to satisfy the requirements of your company to serve its development strategy?



The effect of major increases in insurance premiums on risk management has diminished in the eyes of many buyers, not surprisingly because premium rates have generally softened over in the past four years. Only 26% of the respondents named them as a major external force in 2008, compared to 33% in 2006 and 51% in 2004

European companies continue to expect traditional services from their insurers: policy and other document issuance (52%), claims management (50%), international programme handling (39%) and capacity (30 %).

The difference is modest, but it appears traditional insurance markets are improving their service to corporate clients. One-quarter (2006 – 21%) said insurers fully met their needs while those who said that they still needed to find additional solutions dropped from 62% in 2006 to 57%.

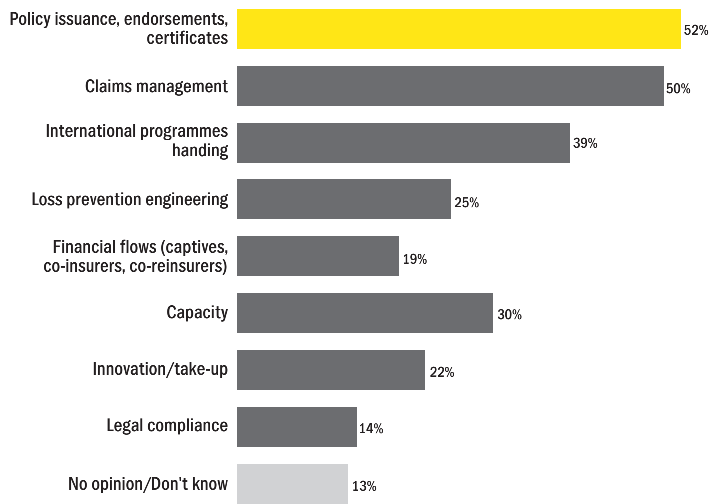
Insurance rates are generally seen as stable and increasing for some lines of business only by those who are involved in the insurance buying process, which does not include the whole sample Only for environment-related risks and directors' and officers' and other liability do more than 30% believe that prices will go up in the medium term. Environmental risks show the greatest consensus with 48% expecting to see an increase and only 7% expecting to see reductions.

Ways of managing the cost of insurance showed considerable consistency: 56% named increased retentions and deductibles, competitive marketing and loss prevention as methods. In 2006, half the respondents said they expected to see more use of alternative solutions, but there seems to have been little change over the two years. Thirty-four percent said they used alternative solutions in 2006 and 31% in 2008.

Pressure over issuance of documents is producing some results; 37% said they had seen an improvement, although almost the same number (36%) said they had not. Roughly two-thirds (64%) received their policy documents within three months of inception, although 17% said it took longer.

Contract certainty remains an issue. A request for more transparency in remuneration schemes of brokers is still pending. In general, the insurance market is seen in Europe as very mature and respondents have a good level of trust in the traditional approach to risk transfer.

What are the three most important services that your company expects from its insurance companies in terms of steering and monitoring your insurance programmes?



Moving up to the next level

The next level of maturity will be to better demonstrate that risk management produces a return on investment that goes beyond compliance. The traditional dichotomy of risk versus performance management is being overcome as risk and performance are increasingly seen as two sides of the same coin, as they should together resolve management problems and lead to continuous improvement.

Contacts

FERMA, the Federation of European Risk Management Associations, brings together the national risk management associations of 16 countries.
FERMA exists to widen understanding of risk management and raise its standing throughout Europe with its members and with the risk management and insurance community.
It achieves these aims by working with other European organisations, promoting awareness of risk management through the media, information sharing and supporting educational and research projects.

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