



# *Enterprise Risk Management Culture - The Testament of Effective Corporate Governance*

*CA Delzad Dinyar Jivaasha\**

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## **I. Introduction**

Enterprise Risk Management or ERM, its acronym as commonly referred to, is a mechanism put in place by an organization to have all the core perceived risks, impacting the sustainability and the achievement of the objectives of an organization, looked at holistically and not in silos. The underlying philosophy is to have a framework that aims at or focuses upon assessing, evaluating and managing entity level risks in an effective manner.

ERM is increasingly being regarded as the **Eyes and Ears of Business**. With every passing day and the recent events, such as the outbreak of the corona virus pandemic that has had far reaching ramifications affecting the business world, have further stressed on the need for a robust ERM framework to ensure that an organization stays resilient and is able to withstand a potentially adverse trend witnessed in the external environment and the economy.

However, a fundamental aspect required to ensure the success of ERM is the acceptance of ERM as a vital cog in the wheel of Governance and Sustainability **by every stakeholder and function** in an organization. ERM can succeed only when it is recognized as a Business Partner Function, which aims at working hand-in-hand with the business and other core functions in order to ensure that the organization achieves its laid out objectives through well-defined strategies, whilst continuing to protect its balance sheet - unfettered by any adversity.

Therefore, building ERM into the DNA of an organization and make it an essential fabric of the work culture is fundamental to a company being regarded as a leader in the sphere of Corporate Governance and in turn adding value to all stakeholders.

## **II. Meaning of Organizational Culture**

Very simply put, culture is what you would do “*when no one is looking*”. In fact, it is one thing

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\* *B.Com, ACA, ACS, ACMA, LL.B., DISA (ICAI), FIII  
Associate Vice President - Risk Management, ICICI Lombard General Insurance Company Limited  
E-mail: delzad.jivaasha@icicilombard.com*

for a thought process or action or response to come very naturally at our end and completely another thing to react because *may be we are being watched* or monitored.

Culture symbolizes the initial scenario where our thought process and responses to either a particular problem or a situation or business case when at the work place. It comes naturally, promoted by the values, principles and philosophy imbibed in our way of thinking by the organization we are associated with.

Very often, we would have observed that two organizations may behave differently in a given situation or at times, may even have similarities in their approach to a particular scenario – this exactly is an outcome of the culture adopted by a Company over a period of time.

Culture is inculcated by an organization over the years by adopting certain practices and aligning to certain methodologies while analysing, evaluating and responding to certain situations. Over a period of time a fair number of employees of the company tend to exhibit similar or uniform approach or behaviour whilst reacting to a given scenario. This pattern of action is then ingrained into every new employee who joins the Company as well and it comes to be known as *The Culture of an Organization*.

Accordingly, it is extremely crucial to ensure that the organizational culture recognizes ERM as being of foremost importance and accordingly, puts into practice the core principles of ERM prior to effecting any decision or undertaking any activity. The same goes a long way in building a sustainable entity and in ensuring that an organization maintains the leadership position it has built up over the years through the virtues of patience, perseverance, innovation, adhering to ethical values and transparency in doing business.

### III. Core Essentials of an ERM Culture

An ERM culture is not easy to build. Furthermore, building and sustaining it requires a strong commitment from the stakeholders across the length and breadth of the organization. Certain core essentials of an ERM culture would include the following:

#### a) **Tone from the Top**

***Tone from the Top can be a huge differentiating factor in building an ERM culture.***

*“Tone from the Top” refers to the approach, philosophy and strategies adopted and practised by the Top Management personnel of the organization, who with their inspirational background and rich diversity of experience, can play a major role in influencing the thought process and behaviour of all employees of the organization.*

The response approach and activities of the top management comprising therein the Director’s and Executive Heads, to various Company-wide initiatives and activities, the day-to-day strategic approaches adopted to protect the sustainability of an organization,

the risk based evaluation carried out prior to implementing any critical decision, goes a long way in sending out the right signal to the senior, middle and junior management employees.

The behaviour and philosophy of the Top Management is certain to be observed and practised by all employees and stakeholders, with the same percolating downwards in the day-to-day workflow, decision making and operating style of an organization.

As a consequence of the above, Tone from the Top becomes the guiding force and the torch bearer for building an effective ERM culture driven by the core fundamentals of Corporate Governance.

From the perspective of best practices witnessed in the space of an ERM driven Culture, organizations which practise a mature risk culture would tend to exhibit the following essential qualities, amongst other factors:

- Effective Communication's from the Top Management to all employees stressing upon the importance of ERM for the organization
- Risk conscious employees being appreciated and felicitated by the senior management on company-wide platforms
- Active Participation by the Top Management in internal Executive Committee's on Enterprise Risk Management
- Close monitoring and accountability management of actionables emanating from internal executive committee meetings on Enterprise Risk Management.

#### **b) Active Participation by All Stakeholders across the Organization**

***Every employee is a risk manager in his area of work.***

All Stakeholders across the organization need to appreciate and understand the importance of ERM, knowing that organizations which have failed in the space of effective ERM practices - have failed to survive over a long term horizon.

Every employee who undertakes a particular work or activity day in and day out, is in the best position to understand and assess the risks with respect to his/her specific work portfolio.

Likewise every member of the senior management, whilst undertaking a decision in his/her core area of work, should understand the nuances and criteria which are required to be considered for undertaking effective decisions benefitting the organization.

During the risk identification, assessment and evaluation - it is extremely crucial that all the employee's involved spare time from their routine schedule's and attend risk management

meetings, including actively contributing and participating in terms of discussing and highlighting the material risks and controls with respect to their area of work.

In order to achieve the above, it is crucial that employees across all levels in an organization regard ERM as a priority activity for the overall benefit of the organization.

The ERM function of an organization would also gain significant insights on risks and related controls, from the experienced professionals who have handled a particular work portfolio over the years.

Again, a few commonly witnessed best practices across risk mature companies would be:

- Cross Functional Think Tank of senior experienced employees who meet at pre-defined intervals to brainstorm on areas of relevance to the organization from an ERM perspective
- Active participation by stakeholder employees of a function, across levels, in the Risk & Control Self-Assessment (R & CSA) activity conducted by the ERM function, including Identification, Assessment and Evaluation of Risk
- Active participation by employees in training sessions on risk management conducted by the ERM function.

### c) **Continual Engagement and Communication**

***Risk Management is a 24\*7 activity.***

Accordingly, it is crucial that all stakeholders continually identify, evaluate and monitor the risks related to their area of work and make their presence felt at every stage of the ERM process, including the pivotal Risk and Control Assessment activities driven by the ERM function of an organization.

Any regulation/rule amendment or a change in government policy or a change in systems and processes being adopted by an organization or a change in the strategy of the Company, is certain to alter the risk profile of the organization, either in a major way or in certain cases, only in a minor way.

Therefore, an ERM culture requires a risk based decision making approach before undertaking any decision e.g. carrying out a detailed risk evaluation before introducing a new product or process or bringing on board a new vendor or entering a new geography or market, etc.

Risks keep evolving and accordingly it is essential to ensure that all stakeholder functions continually engage with the ERM function for carrying out regular updation's of their risk profile which in turn goes on to impact the risk profile of the entity.

Whenever any risk incident occurs, an ERM driven culture ensures that the concerned stakeholder function would proactively communicate and report the occurrence of incident and its related impact on the organization, to the ERM function, to ensure that the root cause analysis of the incident can be carried out and preventive controls/mitigation plans can be put in place to avoid a recurrence of the referred incident.

The above mechanism would also ensure that the requisite and updated reporting's on risk management practices are communicated to the Risk Management Committee and the Board of Director's. **This is fundamental to effective Corporate Governance.**

A few commonly witnessed best practices with respect to continual engagement and communication across risk mature companies would be:

- Evaluating the impact of every decision from a risk perspective i.e. integrating risk based thinking into the decision making philosophy of the Company
- Continual participation by employees through evaluating the impact of every new regulation and government policy on the company's risk profile
- Proactive reporting of new and emerging risks by each stakeholder function to the ERM function on a continual basis.

#### **d) Learning Analysis and Training**

*To sustain a risk culture is pivotal.*

It is pivotal to keep learning from risks encountered by different organizations, both within the industry and outside the industry, across the globe including the successful approaches and best practices adopted to manage the witnessed risks.

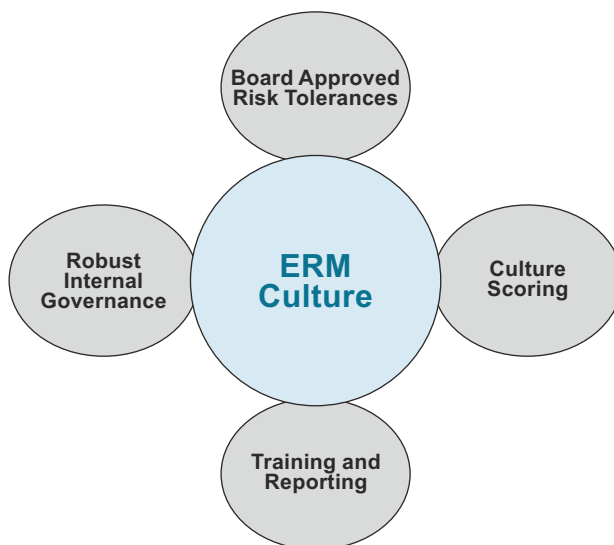
The above proactive measures would definitely extend to risks witnessed or issues faced by the organization itself, across functions; the success or failure witnessed in mitigation plans adopted by the company and accordingly learning from the same through continually evolving robust and effective strategies.

Therefore, the organizations where an ERM culture is ingrained into the workflow would tend to have a master library or register which documents the history of events including the learnings observed from the risks encountered, the mitigation plans implemented in a given scenario and the success/failures witnessed through the implementation of the referred plans. Building up such a legacy over a period of time would be a huge benefit to the organization, for generations to come.

To achieve the above, an extremely important practice followed across risk mature companies is that every new employee joining the organization is trained on the core fundamentals of ERM based decision making process and approaches adopted by the

organization and thereby inducted to regard ERM as a vital activity for ensuring the Profitable Growth and Long Term Sustainability of an entity.

#### IV. Practical Approach Adopted By The Insurance Industry Towards Building An ERM Culture



In the insurance industry, an enterprise wide risk management driven culture is of extreme importance. For an industry which writes various categories of risks on its books, an ERM driven culture is of pivotal importance.

Certain critical and core strategies adopted by the insurance industry to further ingrain an ERM culture in the organization's DNA would be as follows:

1. The insurance sector companies focus on ensuring that their risk profile is divided into certain major risk groups such a ***credit risk, market risk, operational risk, underwriting risk, strategic risk and so on***. Each of the risk groups would be further divided into various risk categories and sub-categories of the risk profile of the company under consideration.
2. The insurance sector companies focus on ***defining their risk tolerance's through Key Risk Indicator's (KRI's)*** which give a perspective into the levels of risk acceptable to a Company.

The risk tolerances cover various risk areas a company is exposed to and aim at quantifying the levels of high risk, medium risk and low risk for a company for each of the referred risk areas.

To give an example, if an entity want's to assess the quality of its investments, it may build an acceptable level of risk through defining a specific x percentage of total investments which can be impaired as a result of the non-performance of investments in the market.

The referred percentage would be company specific and based on the overall investment portfolio dynamics and investment strategy.

The tolerance levels for various identified risk categories would be presented to the Risk Management Committee of the Board every quarter, which is a further testimony to the ERM culture driven philosophy.

3. The insurance sector puts strong emphasis having in place internal Governance Committees comprising of Heads of Functions to better manage the risks and aim at building an ERM driven culture.

For the insurance sector, the Heads of Functions forming part of the referred Committees would include therein The Chief Risk Officer, The Chief Financial Officer, The Chief-Underwriting and Claims, The Chief - Human Resources, The Chief Investments Officer, The Chief - Re-insurance, The Chief - Customer Service, The Chief Technology Officer, The Chief - Legal and Compliance, The Appointed Actuary, etc.

**For example**, certain internal risk and governance committees constituted by the Indian insurance companies in their respective organization's would include the *Operational Risk Management Committee (ORMC)*, the *Market Risk Management Committee (MRMC)*, the *Credit Risk Management Committee (CRMC)*, the *Outsourcing Committee (OSC)*, the *Environmental, Social and Governance (ESG) Risk Committee*, etc.

Each of these committees constituted by the insurance sector companies would look to manage the specific areas of risk for which the committees have been constituted and the exact terms of reference (TOR) of each Committee would be decided by the specific insurance Company

4. For reporting of risk incident specific losses, a practical approach adopted by the insurance industry endeavours to focus on ensuring that the ERM function trains the stakeholder functions on risk reporting's and **provide ERM culture scores to every single function/unit**, which would be communicated to the Management Committee (MANCOM) stakeholders of the organization.

*To give an example, if a function/s reports a risk incident proactively as an outcome of their own initiative, the function would be awarded a higher ERM risk culture score vis-à-vis the risk incident pertaining to a particular function being discovered by the ERM function, in which case the score accorded to the stakeholder function would be lower*

5. Another approach adopted by the Insurance sector towards culture building is to undertake periodic surveys and obtain the feedbacks of employees on the Enterprise Risk Management activities of the Company and also assess the levels of knowledge of employees on ERM.

*To give an example, six monthly surveys are undertaken by insurance sector companies and various risk management specific questions are asked to the employees, to assess their levels of knowledge and concept understanding about ERM including the focal point of questions being the reporting of risk incidents to the ERM function of the organization upon discovery.*

The same gives the ERM function a perspective into the training and other needs of the employees, which further strengthens the culture of ERM in the company.

## V. Conclusion

As we would have observed, certain organizations have succeeded in a big way over a time horizon, whereas others have missed to make a mark.

However, the one common characteristic witnessed by all organizations that have retained their market leadership position and have stood the test of time is that - they have continually laid emphasis on ERM and Corporate Governance and endeavoured to continually add value to all their stakeholders.

Such organizations have built a strong reputation and a sense of confidence towards the organization in the minds of customers, regulators, investors, employees and other stakeholders. Till the time, an organization continues to adopt an ERM driven culture and prioritize Corporate Governance at the heart of its philosophy - this reputation and confidence is sure to stay.

## References

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