



## Three Lines of Defense in Japan: Where from Here?

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# Before we start...

The questions we're always asked

- Does risk management bring any value?
  - Why do corporations manage risks?
  - Reduce or promote risk taking?
  
- How good can a model be?
  - Snapshots of the complex reality
  - “Good / Bad” or “Right / Wrong”
  - “Roughly right” or “precisely wrong”
  - Backward looking or forward looking
  - Calibration difficulty (not only technical but also philosophical)
  
- Best practice
  - “Three Lines of Defense” model?



# Three lines of defense

Where are we?

- Broadly, although shallowly, understood concept
  - There are “three” lines and the 1<sup>st</sup> line has to do “something”
  - 3<sup>rd</sup> line is easy to define but how about the 2<sup>nd</sup>?
  - Why do we need 2<sup>nd</sup> line? Should it become redundant?
  
- Emerging realization of the importance of the 1<sup>st</sup> line
  - Vast majority in the 1<sup>st</sup> line
  - The righteous focus by regulators around the world including FSA
  
- Difficulty around the 1<sup>st</sup> line
  - Training and incentives
  - Skills and mindset



# Focus on the 1<sup>st</sup> line

How can we mobilize them?

- The challenge
  - Wide variety of population
  - “Gap” even within investment banks and other whole sale business. Even more for retail organizations and operation heavy organizations
  
- The true challenge is the construction of the 3 lines of defense
  - 1<sup>st</sup> line is not a control or assurance function by construction
  - Need clear policies and rules for them to adhere to, but no policy or rule can cover everything that hasn’t yet been experienced
  
- What can we leverage?
  - Love? Pride? Shame?
  - “Culture”?



# Risk culture

## What is it?

- Allianz's summary
  - “A good risk culture is one where individuals take the decisions which are right for your company even in the blind spots of your ERM framework.
  - It is how individuals decide when they are not being controlled, when the ERM framework is silent and, especially, when the right decision goes against their own personal incentives” (Wilson, 2014)
- History never repeats itself
  - Forward looking risk management is needed
  - No model is perfect and what models can say usually won't lead us to a crisis
  - Backward looking risk management can cause more harm
- How does “culture” work? Or does it work at all?
  - Is there a “best practice” with respect to risk culture?
  - A soft word sometimes used to cover up difficult challenges
  - “Cultural transformation” or “behavioral intervention”?
  - Need clear “dos and don'ts” but this goes against the definition of “culture”, which is a catch all risk mitigant.



## Attempting to define the 2<sup>nd</sup> line...

- What is ERM?
  - Responsible for establishing and maintaining risk management framework
  - Explicit risk acceptance as a key component of risk governance
  - Not to police but to promote appropriate risk taking by making all stakeholders comfortable: risk appetite framework
  
- Where should CRO be?
  - Independent or involved?



# A different 3 lines of defense model

Israeli cyber security structure (Matania, Yoffe, and Mashkautsan, 2015)

- 1<sup>st</sup> line
  - Robustness
  - Immune system
  - Offline (not driven by any specific stimulus)
  - This covers 75 to 85 per cent of attacks
- 2<sup>nd</sup> line
  - Resilience
  - Hospitals
  - Event driven
- 3<sup>rd</sup> line
  - Defense
  - Prevention
  - Attacker driven



# Where from here?

More challenges...

- Is Japanese society “culture based” or “policy and rule based”?
  - Principles vs. rules?
  - Which one do feel more comfortable with?
  - How have we been raised?
  
- “Love” for the organization
  - Similar to the human history of developing from a family, to a tribe, to a nation. How can we build the sense of belonging?
  - How can we enhance the “immune system”?
  - Is the increasing liquidity of labor force helping to enhance the risk culture?





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