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Global Enterprise Risk Management in Insurance

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Meeting the Challenges of Change

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Introduction – A changed world

Turmoil over last several years has led to:

- Industry restructuring
 - New business models
 - More regulation and government oversight
 - Consumer protection initiatives
 - New paradigm for monitoring systemic risk
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Adapting to the new world of risk management

- Flexible risk management programs
- Increase in number of risk types and sophistication
- Link between business operations and effective risk management
- Effective risk culture



A global perspective



Institutions are responding to change

What is Enterprise Risk Management (ERM)?

- “ERM is the process by which organizations in all industries assess, control, exploit, finance, and monitor risks from all sources for the purpose of increasing the organization’s short and long term value to its stakeholders.”
- “Overview of Enterprise Risk Management,” Casualty Actuarial Society, May 2003
- Holistic view of risk
- Identification of dependencies or interrelationships among risks

Understand risk at enterprise level

Informed strategic decisions

ERM is not a compliance activity

Why focus on ERM?

Factors driving changes to risk management practices

High profile failures

- Subprime Crisis
- Credit Default Swaps
- Banks, Insurers
- Cat risk (natural, other)
- Rating agency focus

Global financial crisis

- Market volatility
- Illiquidity in financial markets
- Heightened systemic risks

Regulatory initiatives

- COSO – US initiative for ERM framework
- SOX – US Internal control framework
- Dodd-Frank and systemic risk
- Basel II/III – BIS international bank oversight
- Solvency II – EU insurance oversight
- NAIC SMI

Effectively managing risks increases value

Costs of Inadequately Managing Risks Include:

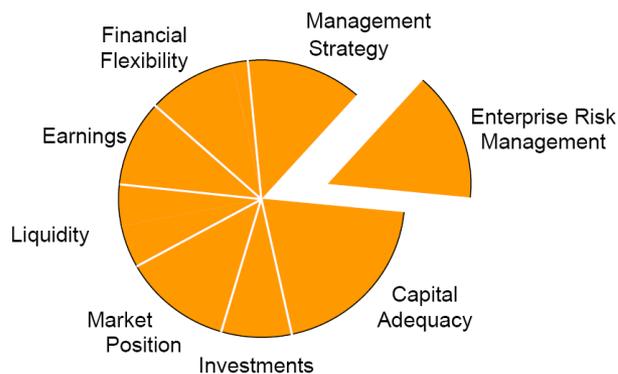
- Reduction in enterprise value
- Variable performance
- Job loss
- Tarnished brand
- Increased cost of capital
- Litigation
- Higher taxes
- Penalties/fines



Rating Agency Perspective – Standard and Poor's

Formal portion of S&P insurer rating process

- Measures all risks consistently
- Incorporates risk into decisions
- Qualitative credit given to risk management practices
- May allow use of internal models for capital adequacy



Basic Principles for ERM Structure and Governance

Culture

- Leadership must set the “tone at the top” and set a clear mandate for ERM throughout the organization. Risk awareness is for everyone
- The ERM program must fit the organization’s culture – i.e., a decentralized organization needs a different ERM structure than one that is centralized

Roles and Responsibilities

- Clear roles and responsibilities must be prescribed for board, board committees, senior management, and other risk personnel
- Risk ownership must be clearly defined and aligned with roles and responsibilities throughout the organization consistent with where risks are taken

Integration into the Business

- The ERM program must be appropriate for the size, complexity and business strategy of the company
- Incentive compensation must drive the desired risk behavior

Communication

- The board and leadership should communicate the risk profile and ensure it is integrated with the company’s strategy
- Process for monitoring and reporting risks is needed. The board must be kept informed of major risk developments and have access to senior risk personnel

Prevailing Practices for Insurance ERM

The quality and strength of risk management capabilities associated with the overall enterprise risk management function and management of individual risks to drive value depend on six key competencies. Insurers utilize these competencies through an ERM process cycle.

Insurance ERM Competencies

Governance and Operating Model – Top down evaluation of structure, interaction, and relationship of corporate risk management with the business units

Resources and Skills – Risk area resourcing, including description of key roles, authorities and responsibilities

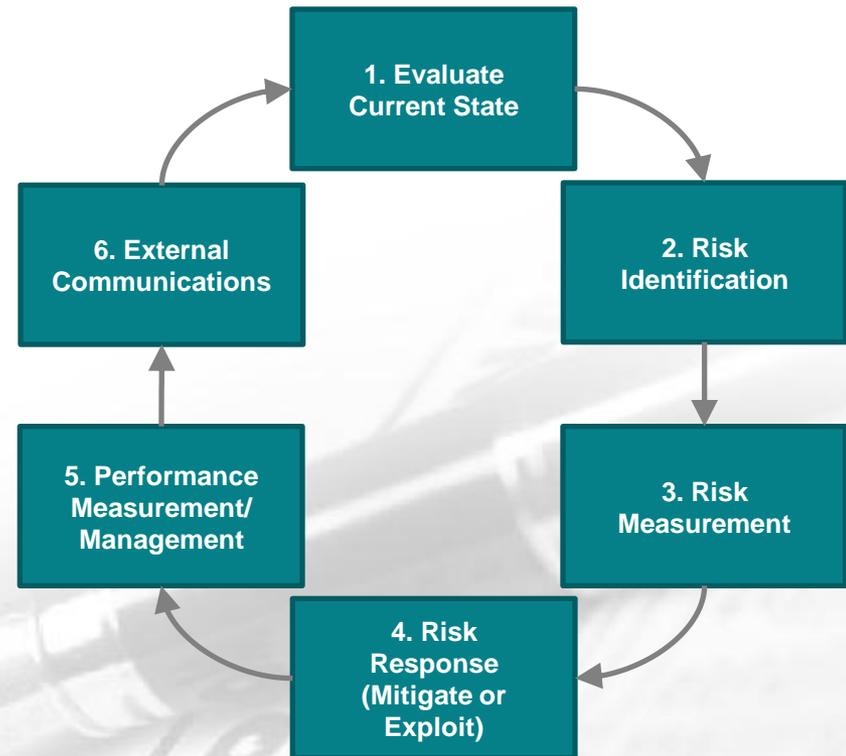
Risk Policies and Procedures – Execution of risk policy through documented procedures

Risk Identification, Assessment, and Quantification – Methods used to identify and analyze probabilities of events and severity of impacts, as well as their interdependencies

Monitoring, Response, and Reporting – Actions and disclosures based upon qualitative and quantitative assessment of risk

Communication and Training – Depth and breadth of communication and training of risk personnel across organization

ERM Process Cycle



Capability assessment and development framework

Assessing levels of ERM capabilities against industry standards can be leveraged to develop an implementation plan, with detailed project plans, to address any identified gaps.

Implementation Activities

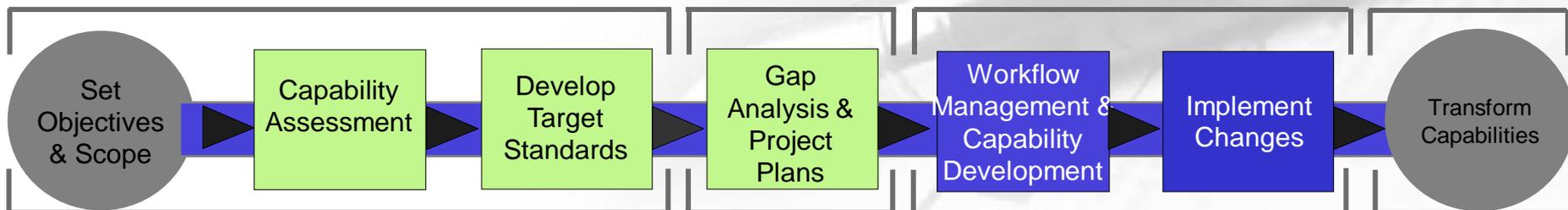
- **Establish objectives and scope** – Clearly agree and define the objectives and time frame for developing ERM capabilities.
- **Assessment** – Understand and map a firm's risk management capabilities against the ERM Capability Maturity Model to benchmark the maturity level and starting point for development plans.
- **Define Targets** – Identify target maturity level for each risk management capability in order to achieve within the time periods established up front.
- **Create Capability Development Plans** – Identify and describe gaps between a firm's existing capability maturity level and targets and create detailed project plans to develop those capabilities that fall short of targets.

Issues and Dependencies

- Success is dependent on proper leadership and governance structure in assessing and establishing scope.
- Capability assessment must be repeated periodically to determine how a firm's ERM capability is sustained and changes over time.
- Targets must cover identified gaps within the firm's ERM capability and prioritize aspects of capability based on the capability assessment.
- Implementation of changes and capability development must follow the plans in order to fill the identified gaps and address current issues.

Capability Assessment

Subsequent Phases



Challenges for implementing an ERM Program

- Data
- Aggregation
- Flexibility
- Technology



Value based ERM

Value-Based ERM is a synthesis of ERM and value-based management

Enterprise Risk Management

- **MARKET RISK**
 - Interest Rate Risk
 - Foreign Exchange Risk
- **CREDIT RISK**
- **LIQUIDITY RISK**
- **INSURANCE RISK**
 - Pricing
 - Underwriting
 - Reserving
- **OPERATIONAL RISK**
 - Human Resources Risk
 - System Risk
 - Business Continuity
 - Compliance Risk
 - Privacy Risk
 - Litigation Risk
 - Etc.
- **REGULATORY RISK**
- **STRATEGIC RISK**
 - Strategy Risk
 - Execution Risk
 - Competitor Risk
 - Disaster Risk
 - Etc.

Value-Based ERM

Enterprise value defined as present value of management-projected distributable earnings, discounted at Weighted Average Cost of Capital

Value-based Management

ENTERPRISE VALUE

Revenue Growth

Claims and Expenses

Debt Service

Taxes

Required Capital

Cost of Capital

Summary

- The marketplace has changed
- Facing unprecedented regulatory change
- Response requires strong risk management and governance
- ERM incorporate a risk culture across the whole organisation
- Majority of institutions have adopted an ERM program or equivalent



