



ERM through the looking glass: the new risk agenda

Enterprise Risk Management Summit

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 **ERNST & YOUNG**
Quality In Everything We Do

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- ▶ Pre-crisis situation
- ▶ Crisis reaction
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Pre-crisis situation

- ▶ Building the foundation
- ▶ Some kinks still to work out
- ▶ Big plans
- ▶ Are we ready for the future?

Most had developed enterprise risk management policies although they were “works in progress.”

continued

Pre-crisis situation

Potential “cracks in the foundation”:

- ▶ Frequent instances of poor governance and segregation of roles
- ▶ Basic risk appetite statements are not quantified
- ▶ Few risk limits monitored and escalated
- ▶ Risk aggregation almost nonexistent
- ▶ Economic capital metrics not in production mode

Crisis reaction — life

- ▶ Conservative companies gain market share
- ▶ Prices to consumers are rising
- ▶ Distribution channels are cautious
- ▶ Focus on fundamental risk management
- ▶ ALM positions are being de-risked
- ▶ Product simplicity is in vogue
- ▶ Capital forecasting and management gain importance

Crisis reaction — property & casualty

- ▶ Price competition remains fierce
- ▶ Distribution channel efficiency gaining importance
- ▶ Fix what is broken
- ▶ Underwriting performance now being measured on a risk-adjusted basis
- ▶ Asset/liability modeling correlations being investigated
- ▶ Enhanced product segmentation and pricing
- ▶ Scenario testing/dynamic capital forecasting methodologies under review

Crisis reaction

2009/2010 company agenda

Industry issues

- ▶ Capital planning and forecasting
- ▶ Capital volatility and repair
- ▶ Improvement in risk segregation
- ▶ ALM
- ▶ Revenue growth pressure
- ▶ Squeezed margins
- ▶ Modeling/stress testing
- ▶ Investor relations
- ▶ Rating agency actions
- ▶ Changing customer environment
- ▶ Regulatory changes
- ▶ Critical mass



Key themes

- ▶ Stabilize
- ▶ Protect
- ▶ De-risk
- ▶ Back to basics

continued

Crisis reaction

Going forward:

- ▶ Risk management to be integrated into company decision making
- ▶ Redefining appropriate risk metrics
- ▶ Balancing financial risk management with structural risk management
- ▶ Redefining roles and accountability
- ▶ Embedding enterprise risk management into company culture

Lessons learned

Risk management practices

- ▶ 'Siloed' risk management and reporting
- ▶ Reporting not 'fit for purpose'
- ▶ Correlations and dependencies not fully understood

Regulatory frameworks

- ▶ Lack of systemic oversight
- ▶ Unregulated markets
- ▶ Weak capital and liquidity standards

Internal factors



External factors

Business and strategy

- ▶ Lack of understanding of risk/return dynamics
- ▶ Unchallenged and weak assumptions
- ▶ Aggregation of risk lacking

Market discipline

- ▶ Lack of transparency
- ▶ Over reliance on rating agencies
- ▶ Complex products

Obama proposal

- ▶ “Our legislation will propose the establishment of the Office of National Insurance within Treasury to gather information, develop expertise, negotiate international agreements, and coordinate policy in the insurance sector. Treasury will support proposals to modernize and improve our system of insurance regulation in accordance with the following six principles outlined in the body of the report:
 1. Effective systemic risk regulation with respect to insurance;
 2. Strong capital standards and an appropriate match between capital allocation and liabilities for all insurance companies;
 3. Meaningful and consistent consumer protection for insurance products and practices;
 4. Increased national uniformity through either a federal charter or effective action by the states;
 5. Improve and broaden the regulation of insurance companies and affiliates on a consolidated basis, including those affiliates outside of the traditional insurance business; and
 6. International coordination.”

Excerpt from July 17, 2009 White Paper

What the future might look like

Business model implications:

- ▶ More dynamic/stress testing
- ▶ A new capital adequacy ideology
- ▶ New compensation structures
- ▶ Capital management creativity

continued

What the future might look like

The risk agenda:

- ▶ Strengthened risk management programs
- ▶ Greater involvement of board and executive management
- ▶ Reduced reliance on complex models
- ▶ Improved focus on pricing and underwriting
- ▶ Increased integration between risk and capital
- ▶ Better ALM

continued

What the future might look like

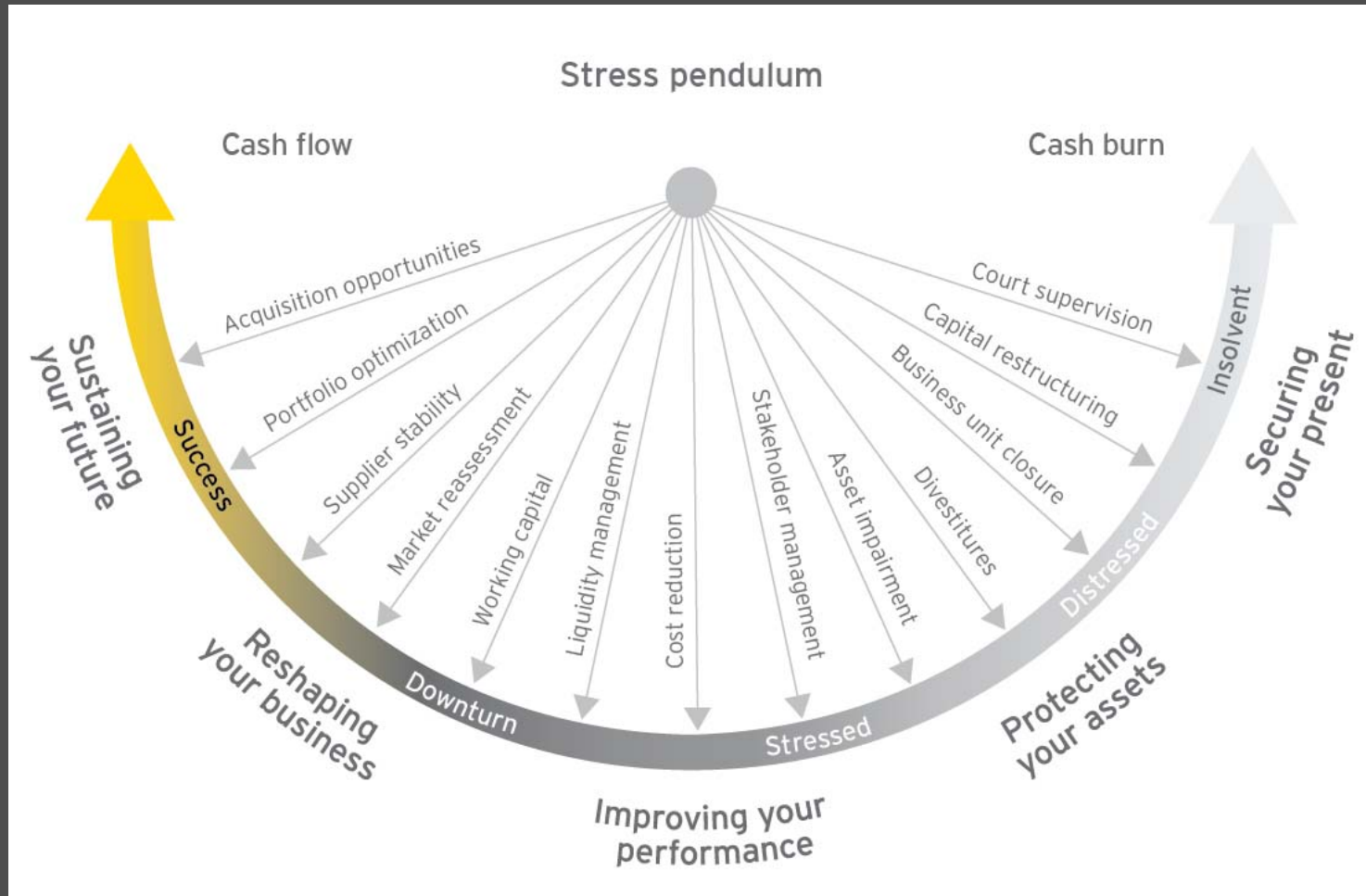
Be ready for:

- ▶ Greater regulatory and rating agency focus
- ▶ Enhanced risk reporting
- ▶ Improved risk governance frameworks
- ▶ New distribution channel demands

How will the CRO role change?

Moving forward

Opportunities in adversity



continued

Moving forward

10 priority initiatives...for now:

1. Challenge current culture of risk committees and risk reporting
2. Develop a quantitative statement of risk appetite and limits
3. Eliminate “groupthink” from the risk identification process
4. Recommend risk-based financial forecasts that link financials to capital/liquidity adequacy and changes in macroeconomic conditions
5. Establish risk-adjusted performance measures that appropriately influence behavior and strategy

continued

Moving forward

10 priority initiatives...for now:

6. Integrate risk measures across businesses and risk types
7. Implement multiple views of risk for increased transparency
8. Improve governance and control
9. Expand static measures to include experience-based simulations
10. Enhance underwriting/product management process