


MANAGING EXTREMES **Willis Re** INTRODUCTION TO ENTERPRISE RISK MANAGEMENT

2014
Session A1



What is ERM really about?



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Enterprise Risk Management

Compliance What do regulators and rating agencies expect?	Capital How much Capital Do We Need?	Practices How do companies manage their risk?
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2

Definitions of Risk Management



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- A.M. Best
 - Risk management is the process by which companies systematically identify, measure and manage the various types of risk inherent within their operations. The fundamental objectives of a sound risk management program are:
 - To manage the organization's exposure to potential earnings and capital volatility
 - To maximize value to the organization's various stakeholders.
- Casualty Actuarial Society
 - The discipline by which an organization in any industry assesses, controls, exploits, finances and monitors risks from all sources for the purpose of increasing the organization's short- and long-term value to its stakeholders.

3

Economic Capital



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- Actuarial Standards Board
 - The amount of capital an organization requires to survive or to meet a business objective for a specified period of time and risk metric, given its risk profile.
- Solvency II
 - Time Period – 1 Year
 - Risk Metric – 99.5% Value at Risk (VaR)
- A.M. Best BCAR
 - Time Period – 1 Year
 - Risk Metric – 98% Tail Value at Risk (TVaR)

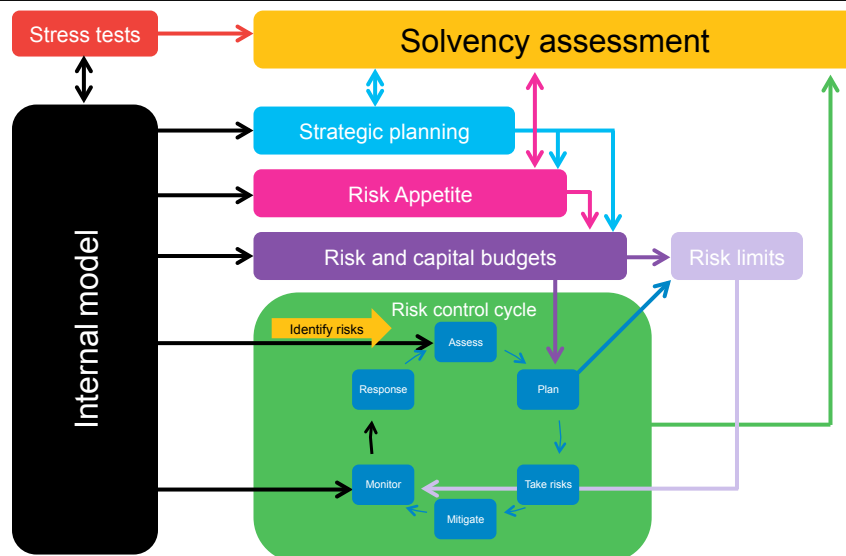
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What is an ERM Framework?



- NAIC
 - A risk management framework assists the insurer with identifying, assessing, monitoring, managing and reporting on its material and relevant risks.
- An effective Enterprise Risk Management (ERM) Framework should at a minimum include the following key principles:
 - Risk Culture and Governance
 - Risk Identification and Prioritization
 - Risk Appetite, Tolerances and Limits
 - Risk Management and Controls
 - Risk Reporting and Communication

ERM Framework





COMPLIANCE

Rating Agency and ERM



- ERM is ingrained in A.M. Best ratings
 - A.M. Best is drilling down into management's ability to identify, manage and measure risk across the enterprise
 - Terrorism risk is analyzed on a deterministic basis
 - Investment strategies remain a focus given economic concerns. BCAR scores stressed for investments
 - A perceived weakness in these areas can affect rating in terms of Best's view on ERM
- ERM is a major category in S&P ratings
 - First introduced in 2005
 - Now includes review of Economic Capital Models

AMB ERM evolution and importance



S&P ERM



ORSA



- Larger insurers must perform Own Risk and Solvency Assessment (ORSA)
- Some smaller insurers are performing voluntary ORSA
- Three parts:
 - ERM process assessment
 - Demonstrate clear evidence of reliable risk control
 - Risk assessment
 - Risk capital determination
 - Solvency assessment
 - Compare surplus and future sources of surplus to risk capital



RISK CAPITAL

Risk Capital Determination Methods



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- Standard factors
- USP Models
- Stress tests
- Simplified stochastic
- Partial internal models
- Full internal models
- Multi-year models with Management Actions
- Willis Re eCCM
 - Economic Capital Coefficient Method

13

Economic Capital Models in Enterprise Risk Management

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Capital Management

- Maintaining retained risk at a level that is supported by capital
- Assist with decisions on use of capital via capital allocation, capital budgeting & return on risk
- Making strategic choices regarding business mix that produce superior risk adjusted returns
- Strategic Asset Allocation

Risk Management

- Identification of risk concentrations to improve ability to avoid large losses
- Control processes over total risk for business units or product lines or territories
- Understanding, communicating and tracking of risk profile
- Demonstrating ERM program to Rating Agencies

Performance Management

- Measurement of risk adjusted returns
- Designing strategies for business units to produce superior risk adjusted business returns
- Goal Setting, management and monitoring of risk adjusted performance
- Risk adjusted incentive compensation

Product Management

- Apply uniform standards across a large organization for product risk and returns
- Product Pricing that is a fair price for the risk taken
- Large case pricing

14



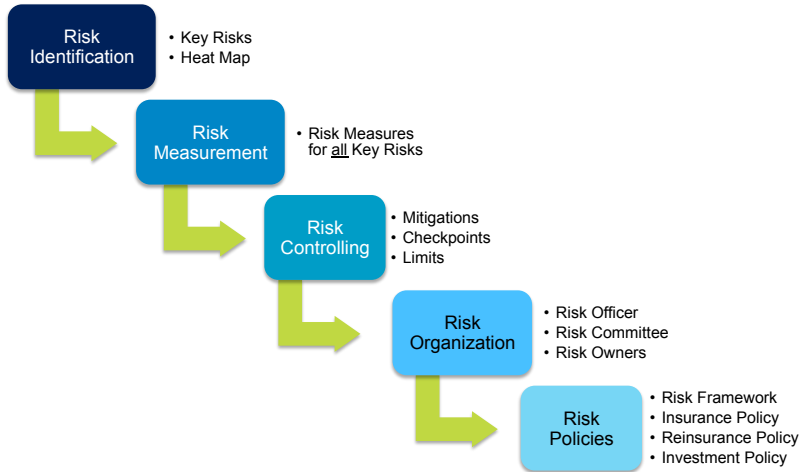
ERM PRACTICES

Willis 20 ERM Practices 14 are needed for ORSA



Key Practices	
Risk Identification	Stress Testing
Risk Limits and Controls	Risk Capital
Risk Measurement	Risk Appetite and Tolerance
ERM Policies and Standards	Risk Reporting
Risk Organization	Risk Management Governance
Enhanced Practices	
Risk Management Culture	Risk Optimization
Risk Learning	Risk-Adjusted Performance Measurement
Change Risk	Risk-Adjusted Compensation
Risk Disclosure	Model Validation
Risk Strategy	Emerging Risks
Required for ERM review portion of ORSA	Required for Risk review portion of ORSA

Five ERM Basics



17

ERM basics



- Willis Re workshops (5)
 - Create a full risk control cycle
 - Reasonable level of ERM practice for many companies
 - 3 to 6 month implementation process



18

What is ERM really about?



Enterprise Risk Management

Compliance

What do regulators and rating agencies expect?

Capital

How is Risk Capital Determined?

Practices

How do companies manage their risk?

19

Introduction to Enterprise Risk Management



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The slide has a black header with the 'Willis Re' logo and 'MANAGING EXTREMES' text on the right side. The word 'Introduction' is written in yellow on the left. The main content is a white box containing a bulleted list of points.

Introduction

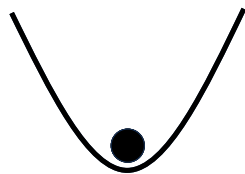
- Willis Re analytics research revealed some basic ideas about risk attitudes (propensities) and risk strategies
 - Many of you already use these ideas every day
 - This session will offer some structure and terminology
- We will discuss applications of these ideas to
 - Risk management strategy
 - Managing through the insurance cycle
 - Enterprise risk management

2

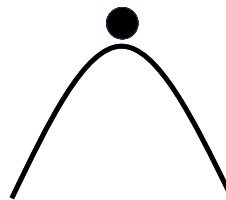
- Introduction
- The theory of plural rationalities
- Risk attitudes and risk strategies
- Seasons of risk
- Risk attitudes & ERM



Four views of risk



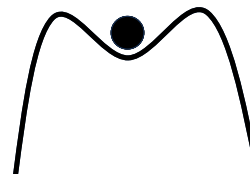
Maximizers



Conservators



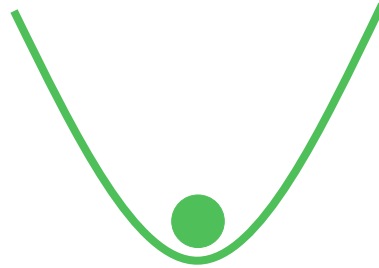
Pragmatists



Managers

Maximizers' view

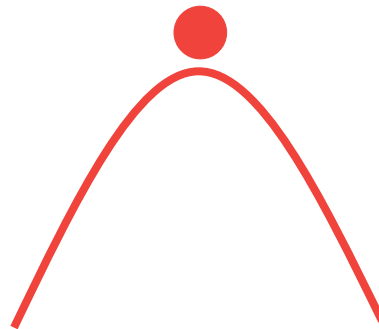
- Risk is not very important – **profits** are important
- It's fine to accept large risks, as long as the price is right
- Risk is mean reverting:
 - Gains will always follow losses
 - The best companies will have larger gains and smaller losses over time



5

Conservators' view

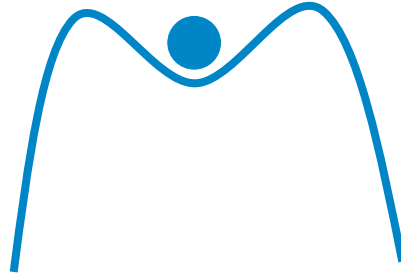
- Increasing profit is not as important as avoiding loss
- Need to **tightly limit** risks
- The world is in a delicate balance
 - Any major change could send things into ruin



6

Managers' view

- Risk is measurable and controllable
- Risk and reward should be **carefully balanced**
- Experts are best suited to
 - Help find risks offering the best rewards
 - Manage these risks to keep firm safe



7

Pragmatists' view

- The future is totally unpredictable
- You can't control risk so there is no point in trying
- It is usually best to
 - Avoid major commitments
 - Keep options open
 - Seek **freedom to react** to changing conditions



8

Introduction
The theory of plural rationalities
Risk attitudes and risk strategies
Seasons of risk
Risk attitudes & ERM

Risk strategies

- Diversification
- Loss controlling
- Risk trading
- Risk steering

Favorite risk strategies

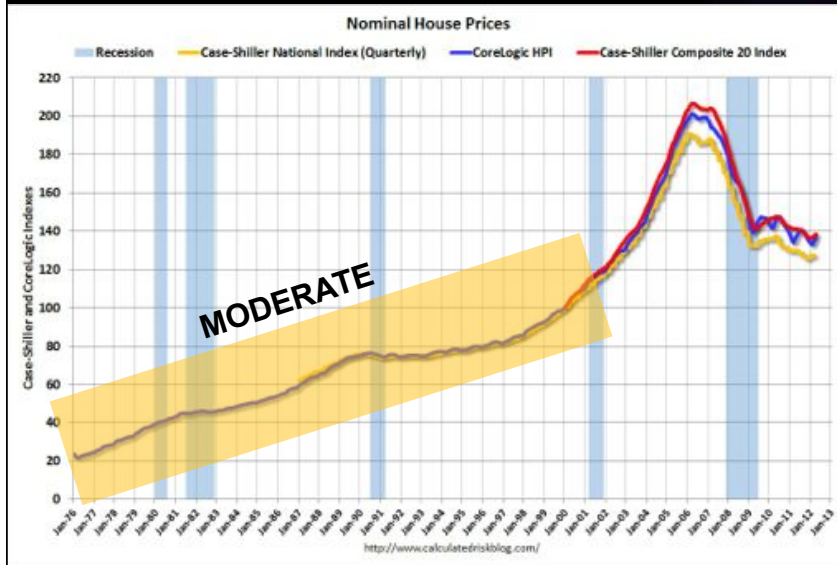


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TODAY'S AGENDA

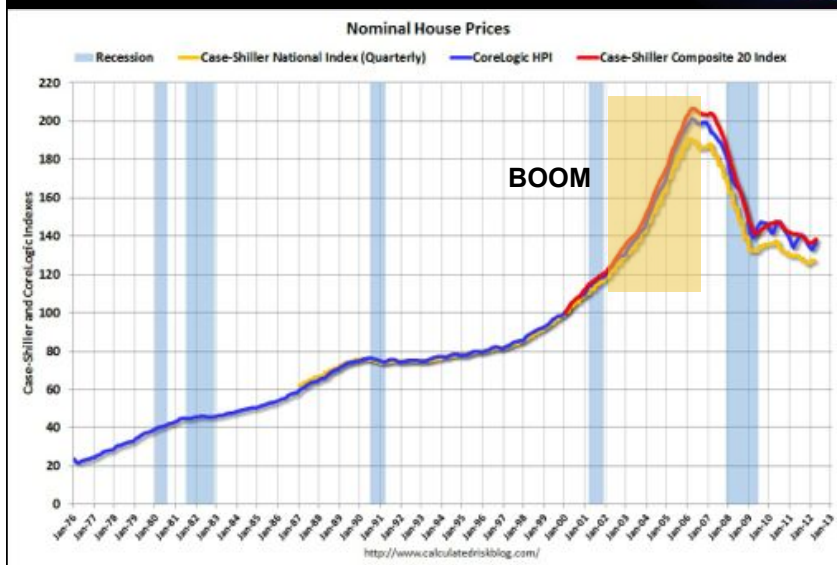
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Four seasons of risk



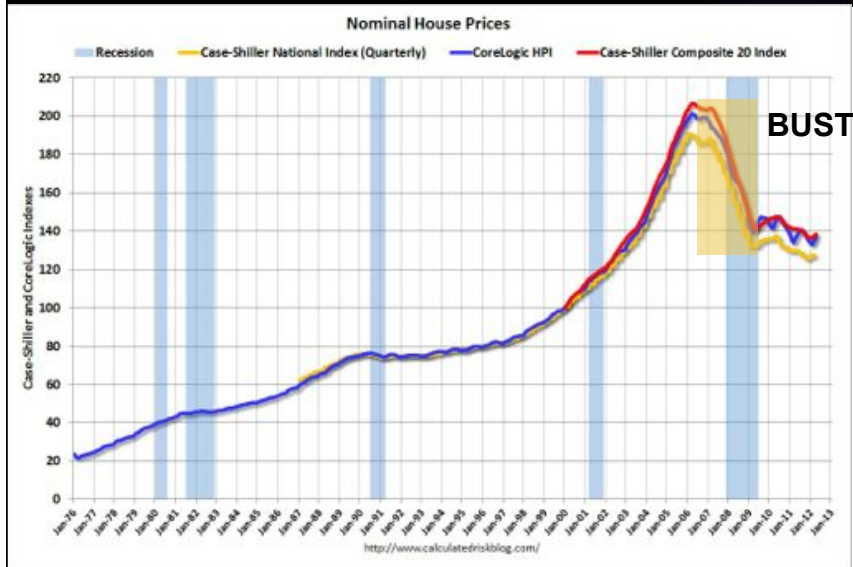
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Four seasons of risk



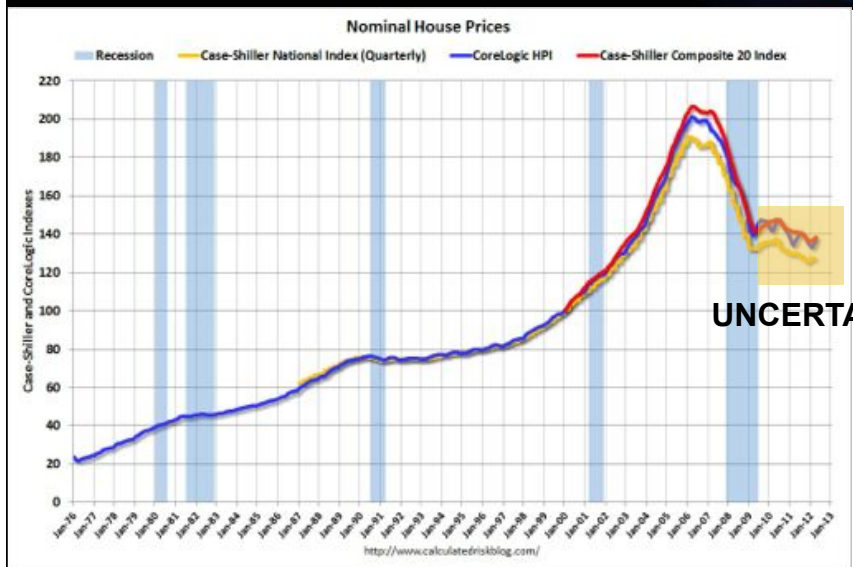
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Four seasons of risk



15

Four seasons of risk



16

Risk environment impacts risk attitude

During the BOOM Attitudes shift towards Maximizer	During the BUST Attitudes shift towards Conservator
In UNCERTAIN times Attitudes shift towards Pragmatist	In MODERATE times Attitudes shift towards Manager

- In the insurance industry, this shifting can be delayed due to the time it takes to recognize losses – especially for long-tailed lines

17

Introduction
The theory of plural rationalities
Risk attitudes and risk strategies
Seasons of risk & the insurance cycle
Risk attitudes & ERM

Rational adaptability

Risk Environment	BOOM	BUST	UNCERTAIN	MODERATE
Risk Attitude	Maximizer	Conservator	Pragmatist	Manager
Risk Management Strategy	Risk Trading	Loss Controlling	Diversification	Risk Steering

A perfect ERM program will adapt to the risk environment

19

Harmonization

- Practical alternative to Rational Adaptability “perfection”
 - An inelegant solution
- Keep all four risk attitudes in the discussion
 - Create compromise strategies
- Must be more than superficial
 - Important to truly value all views of risk
 - Really believe that there is no totally wrong view
- Keep your eye on the rational adaptability ideal
 - Operate somewhere between “stay the course” and rational adaptability
 - Over time getting closer and closer to the ideal

20

Risk Attitudes and Enterprise Risk Management



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