

May 2018

## **ERM Symposium: Miami edition April 19-20, 2018**

*By Max J. Rudolph, FSA CFA CERA*

I believe I have attended every ERM Symposium, chaired the event in 2009, and was on the planning committee until a couple of years ago. It rotated to Miami this year and attracted about 200 attendees. The sessions were interesting and the speakers were people you wanted to discuss ERM with during the break sessions. I will share my thoughts from each session, but here are three of my favorites.

- Scenario testing can be used as a proxy for stochastic simulations, reducing computer time while allowing small companies to do more analysis and bigger companies to perform better analysis when event driven mathematical distributions are limited (part of my presentation in Session 31 but also discussed in other sessions)
- ORSA – regulators continue to push for quantitative metrics to replace qualitative analysis. Also, sharing of group capital reports across jurisdictions is moving forward.
- Make sure terms are defined and understood: stress tests can be split by levels of adversity. These terms are also being used in the Capital Adequacy for Insurers standard of practice exposure draft currently being reviewed.
  - Periods of normal volatility
  - Plausible adverse conditions
  - Extremely unlikely catastrophic events

The keynote speakers were James Lam and Chandu Patel. Chandu shared some war stories from his personal experience. I am using James' book *Enterprise Risk Management: From Incentives to Controls (2<sup>nd</sup> edition)* for a class I am developing for Creighton University this summer. James had a nice slide covering a risk oversight report that he uses with boards.

- Executive Summary
- New Losses & Events
- Follow-up on Prior Losses & Events
- Emerging Risks
- Key Risk Reviews and Metrics vs. Risk Tolerances
- Progress against the ERM Roadmap
- Terms and Definitions

I received a question about the Survey of Emerging Risks soon after the conference that I think will be incorporated in the next survey: what types of scenarios/stress tests do you use (especially for cyber and other operational risks)?

I will not be reviewing the sessions in their entirety, just touching on things that I found new or interesting to me. To review all the sessions, including presentations (with slides and audio integrated) visit [www.ermssymposium.org](http://www.ermssymposium.org) . Prior year archives can also be found there.

## **Session 5 Evolution of ORSA in the U.S.**

*Doug Caldwell, Eli Russo, Chad Runchey*

I encourage the reader to review the slides from this session. Abbreviations from ORSA reports used include

- S1, Section 1, Description of Risk Management Framework (corporate governance)
- S2, Section 2, Assessment of Risk Exposures
- S3, Section 3, Assessment of Risk Capital

<http://www.ermssymposium.org/pdf/presentations/2018/pd-2018-04-erm-session-005.pdf>

The NAIC has reviewed about 300 ORSAs so far, generally at the group level. Length varies, but under 60 pages seems to be the sweet spot. The key disclosure lists the exposure of a company to different risks. It remains a struggle to quantify all risks using a consistent metric (Is it better to do a poor job quantifying a risk or a good job qualitatively assessing it? That will be a primary question to answer over the next several years). How do you quantify liquidity risk? Strategic risks and operational risks have been challenging to quantify. Resilience can be shown using qualitative analysis.

Wish list from NAIC

- More quantification
- Deeper dive in S2 and S3
- Add stress testing to group capital assessment
- RBC evolution as C-4 becomes more quantitative
- Corporate Governance Annual Disclosure coming 2020
- Insurance data security model act coming
- Model review standard coming – encourages questions but uses a template
- Always include next steps in ERM process, and be open to regulatory suggestions
- Encourage June 30 submissions, with responses from state DOI by September 30

Eli does not like stress testing for capital assessment, wants more continuous capital results with a move toward a distribution curve and away from a heat map (MR – I don't agree with this, but I think it may be terminology as when I speak with her we are not that far apart). Others suggested that operational and strategic risks could be supplemented with stress tests.

A template listing internal procedures for reviewing ORSAs has been provided to states. Health companies were distracted by ACA for several years and their reports remain

behind life and casualty. The ORSA report is a great resource for a new board member to be given. Ironically, one regulatory tool is referred to as branded risks was presented as a 2 dimensional chart. Focus is the x axis (no, moderate, significant) and Trend is the y axis (stable, increasing, decreasing). Increasing and significant get extra attention.

P/C metrics are more consistent. Life companies are more varied. (this is true for the life companies I am aware of) I'm not sure of the survey where the 8 companies came from, but for capital most used RBC (5), then rating agency capital (2) and economic capital (1). (if I were a regulator I would want to see RBC for all companies as it would be consistent across companies)

ORSA requires projections of capital into the future. It is recognized that this is very difficult and computer intensive to do this for economic capital models. How are EC models tied to strategy?

Dashboards as a primary tool are discouraged (discussion was around Key Risk Indicator dashboard KRI) except as supplemental reports. (I disagree. Boards can dive into specific metrics, but having a consistent dashboard will make them feel better about transparency. Otherwise I would check each report to see what was missing and wonder if a risk was being hidden.

Cyber metrics reported reflects income statement risk and reputation risk. Companies that include earnings at risk (E@R) metrics show it as less than a 5% risk (I agree with speakers that this seems low).

Are the metrics reported actually used for decision making? An example would be dividend policy – if this event happens, will a dividend be paid.

## ***Session 9 Navigating an ERM Launch through an Industry Sector Storm: Health Insurer Case Study***

*Sim Segal, Philip Sherrill*

This session looked at the progress Arkansas BCBS has made in their ERM/ORSA process since starting the process 18 months ago.

A lot of their effort has been to quantify risks that are hard to create a distribution for. They suggest something similar to what I present in my interest rate paper, using deterministic tests as proxies for different points on a cumulative distribution. (not clear how they know how stressful a specific scenario is, i.e., is it in the middle or the tail of a bell shaped curve?)

They define an emerging risk as something outside their top 10 key risks. (I totally disagree – emerging risks are something new or an evolving risk, not something that is unimportant to an organization – this is why it’s important to write down definitions)

Arkansas BCBS has a single page template they fill in for each scenario.

It’s not clear how interactions between risks are handled, if at all.

<http://www.ermssymposium.org/pdf/presentations/2018/pd-2018-04-erm-session-009.pdf>

### **Session 11 Insight Available to Download**

*Jessica Dang, Max Rudolph, Tom Herget, Sam Gutterman*

This session covers SOA research projects and other information that is available for free on the internet. Jessica covered her project about creating proxies for tail scenarios for variable annuities, followed by an overview of my emerging risk survey. Tom and Sam spoke about the IAA book covering ERM topics, and Sam presented info from his paper in progress on the Social Discount Rate. His discussion of how this might apply to climate change scenarios was one of the highlights of the seminar for me.

<http://www.ermssymposium.org/pdf/presentations/2018/pd-2018-04-erm-session-011.pdf>

### **Session 18 Building Buy-in: Overcoming the Number One Obstacle to Effective ERM**

*Sim Segal, Philip Sherrill*

This session was very similar to Session 9 (same speakers), with the word buy-in inserted on some of the same slides. Philip Sherrill was very interesting to listen to. As an auditor he came to ERM with a different perspective and he is building something that works for Arkansas BCBS.

I am still struggling with how to work with strategic risk and how to quantify it. It seems like most strategic risks are really driven by another risk, so why is it included with strategic risk rather than with the risk that drives the result. I do think that a risk like your CEO being an idiot belongs here, but no one lists that or is willing to put frequency/severity to it. Strategic risks are important, but if included in a separate category should also be backed out of the original risk. Example – company decides to mismatch their assets shorter than liabilities because interest rates are “sure” to rise. This is ALM risk and should not be included in both places.

<http://www.ermssymposium.org/pdf/presentations/2018/pd-2018-04-erm-session-018.pdf>

### **Session 21 Building a Strong Risk Culture**

*Liz Berger, David Brentlinger, Adam Hamm*

This session was a Protiviti presentation with a practitioner thrown in, but surprisingly the session was very interesting. They describe culture as the keystone of ERM, showing the top piece of an arch that is necessary to keep everything together. They use a term, employee life cycle management, that I really like (it includes hiring, career plan, development, exit process, feedback loops). I'm a big fan of lifelong learning and feedback loops.

Culture is encouraged through communication: bad news now, good news whenever. Companies should be proactive about external events, with a branding/reputation response considered in advance and quick response teams in place to deal with them. Your risk processes are more useful when documented and transparent.

One insurer has 5 metrics behind their risk appetite, with 2 levels designed around maintaining their rating.

<http://www.erm-symposium.org/pdf/presentations/2018/pd-2018-04-erm-session-021.pdf>

## ***Session 24 Evolution of Risk Management and Strategic Risk***

*Nicholas Silitch*

Silitch performed a one man show detailing the history of financial disasters. While interesting, it was background for most of the attendees and did not attempt to anticipate any future blowups or dive into the strategic choices made. He did mention one insolvency that I was not familiar with, Colonial Bancshares, which used its FDIC guarantee to draw in money in 2007 much like the S&L industry had done a decade earlier.

Liquidity risk should include the risk that derivatives require collateral. This risk is very hard to model accurately.

<http://www.erm-symposium.org/pdf/presentations/2018/pd-2018-04-erm-session-024.pdf>

## ***Session 31 Stress and Scenario Testing for ORSA, CFT, and Strategic Planning – Issues to Consider***

*Max Rudolph, Mark Alberts, Dave Ingram*

This was the last session of the conference, and surprisingly well attended. The audience tilted slightly toward P/C over life practitioners (no pension/health). I presented some highlights from my interest rate research, showing how a few well-chosen deterministic scenarios could serve as a proxy for a stochastic simulation.

Mark Alberts shared his deterministic research project and some other ongoing research, noting that failure of imagination was a problem that practitioners need to deal with. In the audience about half used increasing rates as their base scenario (not good as these

result in positive results – are boards aware of the upward income bias in what they are shown?), but some include negative rates in their stress scenarios.

Dave Ingram shared a framework for developing stress tests, and I encourage readers to look at his slides (and listen to the audio) to see how to develop a structured process. He uses a power law analogy (Nate Silver provides a good explanation/examples in *Signal and the Noise*), comparing worst historical to second worst to develop a distribution. He separates stress tests into normal volatility (worst in 5 or 10 year period), historic worst case (worse in 20 years), realistic disaster, and an unrealistic disaster. He noted that in every group he has polled (including this group) that there is disagreement between people about how to classify these events. This is one of my key takeaways from this conference.

<http://www.ermssymposium.org/pdf/presentations/2018/pd-2018-04-erm-session-031.pdf>

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