

Enterprise Risk Management Adding Value for Investors

**Global Best Practices in ERM
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Inquiring Investors Want to Know

- Can I understand the company's strategy and risks?
- Is the company providing external stakeholders with the right information?
- Does the company use this information to manage the firm?
- Has the company used a unique solution best positioned for their situation?
- Is the company being paid for the risks accepted?
- What emerging risks should investors be aware of?

Risk Management Building Blocks

- Value added
- Knowledge
- Culture
- Compliance

Compliance

- Shortcomings if this is focus
 - Limited additional financial value
 - Checklist
 - Bureaucracy/busywork
 - Tendency for cookie cutter methods
- Positives when done correctly
 - Building blocks for adding value

Culture

- Shortcomings if no buy-in
 - It doesn't work
 - Many examples of failures
 - Enron, LTCM, VA GMDB, Defined Pensions, Sub-prime
 - Biggest problem might be model risk
 - Don't focus on number of PhDs
- Positives when done correctly
 - Alignment
 - Integrity – senior management walks the walk
 - Transparent/Proactive
 - Everyone is a risk manager

Knowledge

- Shortcomings if company isolates knowledge
 - Senior management doesn't understand the risks taken
- Positives when done correctly
 - Competitive advantage
 - Accept risk (sometimes exploit)
 - Not a competitive advantage
 - Mitigate (e.g., hedging, reinsurance)
 - Avoid
 - Can't transfer risk, can only share it
 - Communication to stakeholders

Investor Priorities

- Focus on balance sheet risks first – big hitters
 - Metrics: Duration/Capital/Liquidity
 - Asset/Liability Management/Interest rates/Equities
 - Risk aggregation
- Issues to look for
 - Is there alignment throughout the firm?
 - What constraints does the firm use to manage risk?
 - Is there coordination with other internal programs (e.g., balanced scorecard, incentive compensation)?
 - Is everyone pulling in the same direction?

Model Risk

- Economic capital
 - Sensitivity of assumptions
 - Limited significant digits
- Key is how you use the tools, not how sophisticated they are
 - Arbitrage free scenarios
- Quantification is less important than culture

Issues for Small Companies

- Cost – must prioritize
- ERM project should provide actionable information
 - Focus on trends of metrics
- Don't accept cookie cutter solutions
 - Each situation is unique

Best Practice - Risk Committee

- Key product officers from across the company
- Chance for other experts to review in advance
 - Avoids some major mistakes
 - Checks and balances
 - Pricing discipline
 - Business units buy in
- Risks debated before accepted
 - Proactive
- Side benefits
 - Succession planning
 - Builds team

Best Practice - Scenario Planning

- Deterministic scenarios
 - Worried about specific event
 - What if once per century hurricane or pandemic
 - Modeling constraint
 - I don't know how to do it
 - Time constraint
 - I can't do it based on lengthy run time
- Stochastic scenarios
 - Learn

Thank you!

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