

Enterprise Risk Management (ERM) for Smaller Insurance Companies

LIC Workshop

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ERM for Smaller Insurers

- ERM Definition
- ERM Process
- Best Practices

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What is Risk?

- Volatility
 - Measured by variance
- Downside
 - Mitigation
- Knightian
 - Uncertainty
 - Unprotected space travel is not risky!!!

Practitioner's Risk Definition

The definition of 'risk' is not standard deviation, it's not volatility, it's not beta; it's what your risk of a meltdown is. What's the risk that you dig your client into a hole large enough that they never recover, they never get out of it? That's risk!

What is Risk Management?

- Identify risks
- Assess risks
- Prioritize risks
- One risk at a time (silo)
- Insurers have lots of risk management practice

What is ERM?

- Considers all risks (holistic)
- Considers interactions between risks
- Considers emerging risks
- Considers responses - both mitigation techniques AND risk opportunities
- Know what you don't know!
- Beware of anchoring bias

Enterprise Risk Management

- “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.”

Casualty Actuarial Society, 2003

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Key Elements of ERM Process

- Define risk
- Identify/prioritize risks – set accountability
- Set risk appetite/alignment (capacity/budget)
- Common language
- Key risk indicators (leading/lagging metrics)
- Environmental scanning – what drives future results

ERM by industry

- ERM Framework/Process is the same
- Risks differ (silos)
- Focus on
 - Interactions between risks - ALM
 - Unintended consequences - suppliers
 - Consistency/standards
 - Communications
 - Small/large company variations

Risk Categories for Insurer

- Investment risk
 - Credit/equity/liquidity risk
- Insurance risk
 - Mortality/morbidity/casualty
- Asset/Liability risk
- Operational risk (business risk)
- Strategic risks

Liability Risks - Examples

- Mortality - obesity/smoking
- Underwriting consistent with pricing
- New business consistency with in-force
- Interest rate level
- In-force product management
- Sales management

Risks Specific to a Life Insurer

- Investment risk
 - Investment Policy Statement (IPS) is key
- Operational risk
 - People
 - Fraud
 - Technology
 - Legacy administration systems/System availability
 - When insured becomes insurer's insurance risk

Role of Board

- Risk appetite – not constant
- Risk culture
- Oversight of the ERM process
- Focus on ERM as it relates to strategic issues
- Common sense

Board Presentations - Tell a Story

- Deterministic scenarios
 - Specific outlier event
 - Modeling or run-time constraint
 - Tactical/strategic plan impact
- Models
 - Board's role is to listen and ask questions
 - Challenge experts – varying viewpoints allow better interpretations

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Make Better Decisions with ERM

- Strategic planning role
 - Understand your risk profile
 - Unique solutions
 - Quantitative/qualitative tools
- Good ERM goes beyond
 - Checklists/risk mitigation
 - Rating agency/regulator requests
 - Black box models

Predicting the Future

- Predicting potential outcomes
- Not predicting actual future events
- **“to be prepared to react is the goal”**
 - Flexibility
 - Common sense
- Source: Emerging Risks Survey 2011

Emerging Risks

- Evolving risks (creeping, mean reverting)
 - Public pension guarantees
 - Home mortgage market
- Tail risk (recently unseen)
 - Earthquake/asteroid/black plague
- The next big risk will be something new

Systemic Risks

- Single regulatory process
- Rating agency oligopoly
- Off balance sheet liabilities
- Low interest rates
- Counterparty risk
- Models (e.g., Black-Scholes)

ERM Best Practices

- ERM used for strategic and tactical decisions
- Risk culture penetrates all levels
- Board/senior management is involved
- Environmental scanning –
 - Steal ideas/emerging risks
- Contrarian thought is encouraged
- Anticipate unintended consequences

Concentration Risk

- Limited diversification
 - Decision making
 - Liabilities
 - Asset classes
 - Models
 - Overhead expenses

Law of Risk and Light (Dave Ingram)

- Risks in the dark grow
 - Rising tide lifts all boats
 - Bernie Madoff
 - AIG credit default swaps
- Risks in the light shrink
 - When the tide goes out we discover who has been swimming naked
 - Regulations lag and mean revert

DON'T FORGET TO LOOK DOWN!

<http://www.ermsymposium.org/2009/pdf/2009-ingram-risk-light.pdf>

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- Rudolph Financial Consulting, LLC
 - Design/peer review ERM and ALM strategies
 - Leverage ORSA and Risk Focused Exams
 - Continuing education and research: modules, seminars, newsletter, predictions
 - Board level ERM sessions
- Professionalism
 - SOA Board of Governors
 - Investment Section Chair
 - ERM Task Force, ASB
 - LOMA Profitability Committee
 - SOA President's Award



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