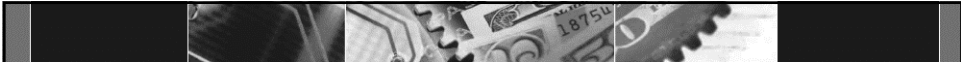


*Welcome to the 3<sup>rd</sup> Annual  
ERM Symposium!*

ERM

2005 ENTERPRISE RISK MANAGEMENT *Symposium*



*Welcome to the 3<sup>rd</sup> Annual  
ERM Symposium!*

Valentina A Isakina  
McKinsey & Company

ERM Symposium Program & Organizing Committee

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2005 ENTERPRISE RISK MANAGEMENT *Symposium*



## *Program Sponsors*

- Casualty Actuarial Society
- Georgia State University
- The Professional Risk Managers' International Association
  - Society of Actuaries

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## Exhibit Hall Hours

Monday, May 2

7:00 – 9:00pm Reception


Tuesday, May 3

7:00 – 8:00am Breakfast

12:00 – 1:00pm Lunch

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Course Agenda  
Special Interest Sessions  
Symposium Evaluations  
ERM Survey  
Antitrust Statement

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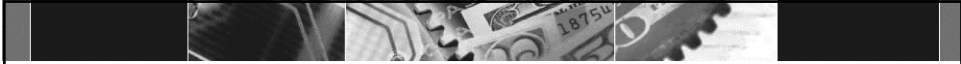


Third Annual ERM Symposium  
Chairperson's Remarks

Dave Ingram  
Director, ERM  
Standard & Poor's

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Every great mistake has a halfway moment, a split second when it can be recalled and perhaps remedied.

**Pearl Buck**

*US novelist in China (1892 - 1973)*

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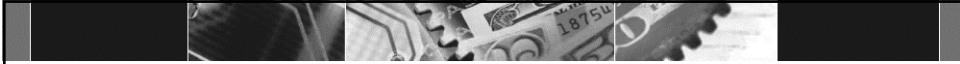


## Risk Management

- Look for those halfway moments.
- Figure out what to do.
- Do it.

ERM

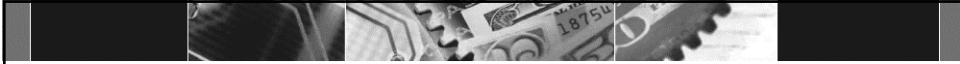
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- 
- Of course the game is rigged. Don't let that stop you--if you don't play, you can't win.
    - **Robert Heinlein**  
*US science fiction author (1907 - 1988)*



## Risk Management

- Do not be surprised when the world does not conform to your excellent models
- Recalibrate and move on

- 
- It's wisdom to recognize necessity, when all other courses have been weighed, though as folly it may appear to those who cling to false hope.


– **J. R. R. Tolkien**

*British scholar & fantasy novelist (1892 - 1973)*



## Risk Management

- Trust your judgment.
- The majority may not be right.

- 
- But in all my experience, I have never been in any accident... of any sort worth speaking about. I have seen but one vessel in distress in all my years at sea. I never saw a wreck and never have been wrecked nor was I ever in any predicament that threatened to end in disaster of any sort.

– **E. J. Smith**, 1907, *Captain, RMS Titanic*



## Risk Management

- Use your imagination!

# Enterprise Risk Management: A Practical Solution

Robert Stein

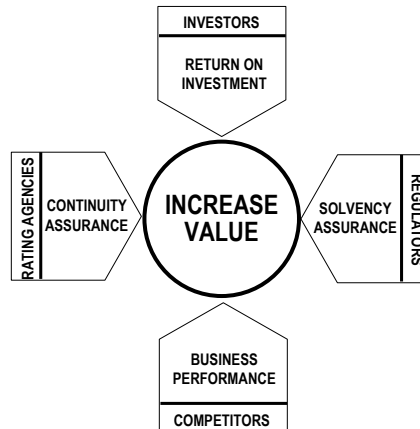


## Agenda

- Enterprise Risk Management - what is it??
- Objectives and benefits of ERM
- ERM implementation challenges and leading practices
- Making it work – effective risk governance elements

## The Changing Business Environment

Investors, rating agencies, regulators and competitors are raising expectations



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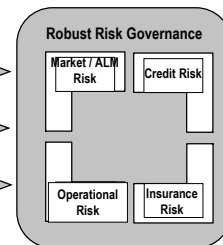
## Enterprise Risk Management – An Effective Response

Integrated risk management processes and related performance metrics are needed to link risk management, capital deployment and value creation

### Historical Approach to Risk Management



### Enterprise Risk Management and Governance Framework



“ERM is the discipline by which an organization ... 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.”

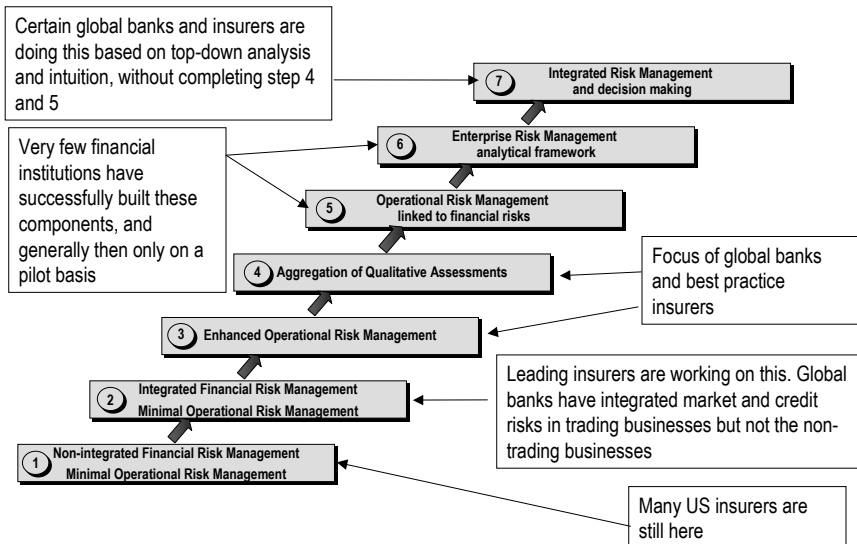
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## Objectives and Benefits of Enterprise Risk Management

- Enhanced measurement and understanding of exposures
  - Consistent measurement of risks across the organization
  - Improved understanding of the inter-relationships between risks
  - Aggregation of exposures from all risks, financial and non-financial
- Facilitate pro-active capital management and efficient deployment
- Support improved business performance measurement and management
- Provide clearly defined, risk-based framework for decision making and maximization of shareholder returns
- Enable oversight of risk profile, mitigation and control strategies and business decisions, which satisfies several constituencies:
  - Board –will have a framework to ensure that risk decisions are made properly
  - Shareholders – are assured that risks are managed properly and minimized
  - Regulators \ Rating Agencies – ERM is a sign that the company is managing their risks effectively

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## The Evolution of Enterprise Risk Management



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## **Integrated Risk Management : Key Challenges**

- No consensus on how to quantify risks
- ALM, pricing, underwriting, credit risk tend to be managed within silos
- Risk management policies and procedures inconsistently applied across businesses
- Linkage of risk and return often weak
- Financial risk information often incomplete
- Non-Financial risk information limited; few controls address Operational Risk; little active management
- Limited resource dedication to centralized function
- Responsibilities for risk identification, assessment, management and reporting not clearly assigned to Board, Senior Management, Businesses and corporate risk
- Minimal independent risk governance and oversight

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## **Integrated Risk Management : Emerging Practices**

- Strong central function, overseeing risk measurement and reporting by product/risk origination, business, geography, entity and risk
- Corporate drives minimum standards; risk ownership retained within businesses
- Use of common risk measure throughout the enterprise
- Consistent standards, policies and procedures across business lines
- Integrating risk management processes into single platform, eliminating "silos"
- Practical definition of risk appetite through tolerances and authority
  - Review approval process for unique activities and limit overages
  - Authorization of new activity, risk tolerances and policies

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## **Integrated Risk Management : Emerging Practices**

- Articulation of non-financial risk drivers
  - Estimation of inherent impact and likelihood
  - Clear mapping of financial risk and non-financial risk to avoid potential double counting
  - Focus on control design and performance
- Consideration of Legal and Compliance issues within the governance framework
- Platform for linking risks assumed to value creation; use of risk adjusted performance measures
- Robust governance structure to enhance transparency and accountability
- Independent governance and oversight of risk levels and risk management processes

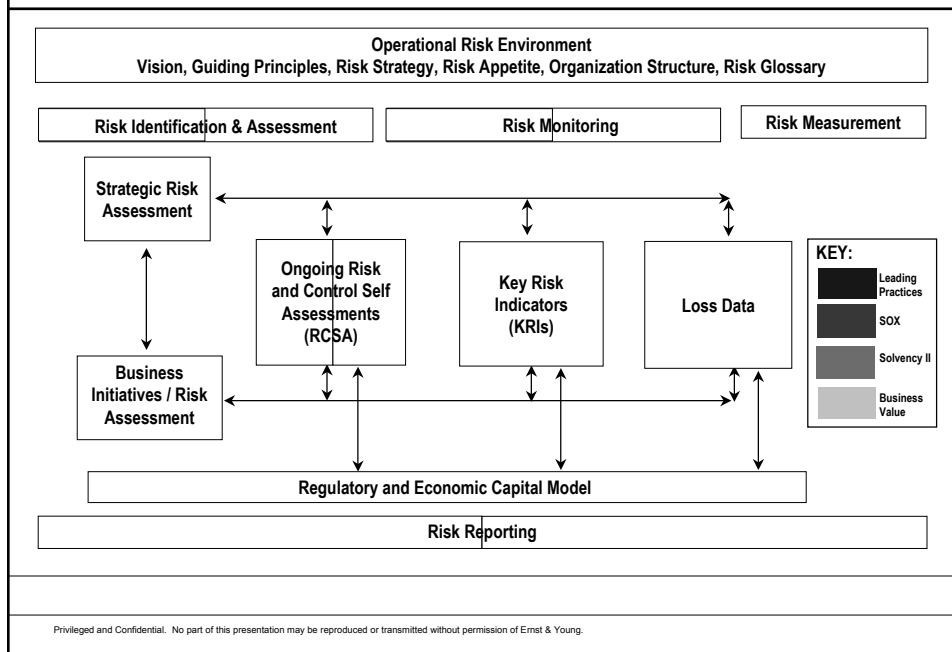
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## **Operational Risk – Overlooked and Dangerous**

- An operational risk framework is a crucial component of an ERM system
  - Growing frequency & severity of operational losses
  - Operation risk events can lead to destruction of shareholder value and insolvency
  - Reputational damage from such events can be significant
  - Growing regulations concerning capital allocation for operational risk
- Operation risks exist in all aspects of insurers' businesses
  - Brokerage / Agent relationships, including compensation programs
  - Business ethics, mis-selling, product suitability
  - Pricing and product design
  - Reserving
  - Claim adjudication
  - Reinsurance placement

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## Operational Risk Management Framework



## Risk Governance Framework – Goals and Objectives

### Overall Objective:

### Enhancing Business Performance

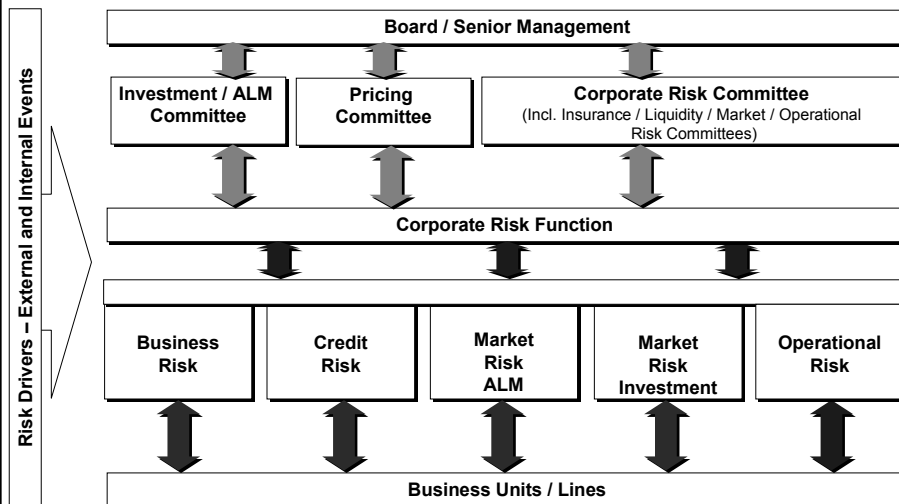
- To enable the enterprise to facilitate better risk management through:
  - Managing risk aggregation by type (by risk silo)
  - Managing the portfolio of combined risks
  - Communicating expectations across the business
- To support and improve business decision-making by providing a holistic and complete view of the business
- To provide mechanisms for more accurate, relevant and timely information – for improved business management

### Overall Objective:

### Improving Level of Assurance

- To ensure that businesses identify risks and adopt controls to prevent risk exposures from becoming control failures
  - To provide management/board with better assurance that the business is being directed and controlled effectively and efficiently – ensuring 'no surprises'
  - To address regulatory expectations and requirements – providing external stakeholders with better assurance
  - To enhance the degree of transparency and accountability; reduce significant reputational risks
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## Implementing a Risk Governance Framework



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## The Role of the Corporate Risk Function

- Identify all risks and define measurement methodologies and implementation guidelines
- Integrate individual risk types into a single portfolio
- Facilitate determination of risk appetite, including limits, authorities, etc
- Design and implement an appropriate corporate governance framework and supporting infrastructure
- Ensure that risk responsibility and control ownership is understood and being correctly implemented by the businesses
- Ensure mitigation strategies and action plans have been enacted by the business units and functions
- Drive reporting and communication of risk issues to the board and third parties, including shareholders, regulators, rating agencies
- Monitor the effectiveness of the risk management framework as a whole; recommend improvements and enhancements

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## Conclusions

- ERM enables insurers to break down risk silos and move toward an integrated risk management process – but needs a common measurement framework
- ERM supports the implementation of practical risk policies
- ERM can allow insurers to optimize the use of capital and maximize shareholder return
- ERM addresses critical operational risks and can leverage the investments made in complying with SOX 404
- Governance processes lay the foundation for building and maintaining risk-aware processes, cultures and product portfolios
- ERM will meet growing expectations of regulators and investors



## Frontline Briefing on ERM

ERM Symposium  
May 2, 2005

**James Lam**  
President  
ph: 781.772.1961  
jameslam@comcast.net  
www.jameslam.com

### ERM implementation – critical do's and don'ts

---

1. Don't let the regulatory tail wag the dog – ERM is about management, not simply compliance
2. Don't boil the ocean – focus the ERM process on what is most important
3. Don't just tell me, show me – quantify risks through effective key risk indicators
4. Don't produce volumes of data and reports – develop an ERM dashboard

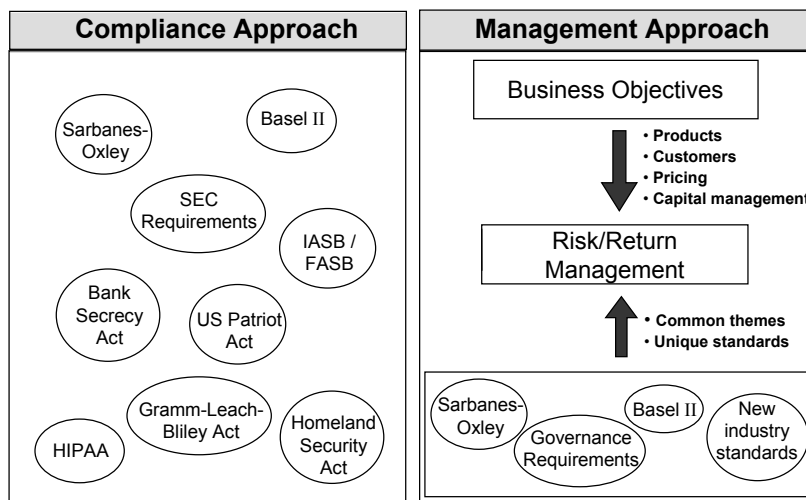
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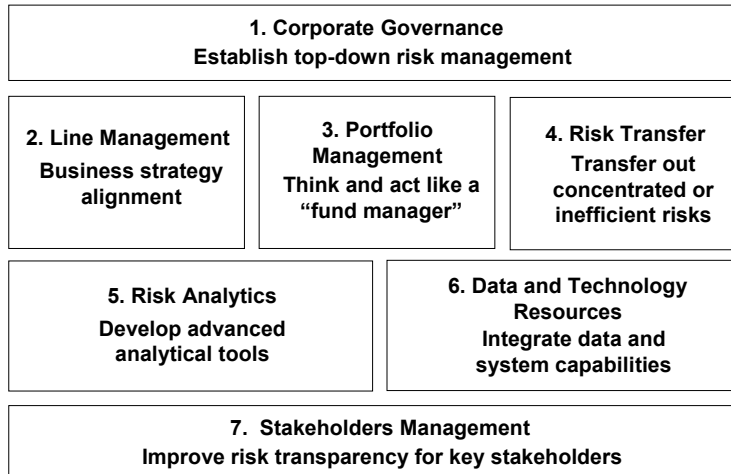
## Regulatory compliance is a necessary but insufficient condition for success

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## An ERM framework should encompass seven key building blocks

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## Focus on ERM at the Federal Reserve

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- Chairman Greenspan: "Indeed, better risk management may be the only truly necessary element of success in banking."
- The Federal Reserve Board and all twelve district Banks are in the early stages of ERM development.
- Governor Olson – In 1966 the First Bank System conducted its first external audit as a optional exercise, but now it is a requirement. Predicts the same for ERM.
- Governor Bies – ERM and internal controls (COSO) are not the same:
  - ERM is a **management** process focused on risk/return dynamics of customers, products, pricing, and costs.
  - Internal controls are part of a **governance** process focused on authorizations, documentation, and process integrity.

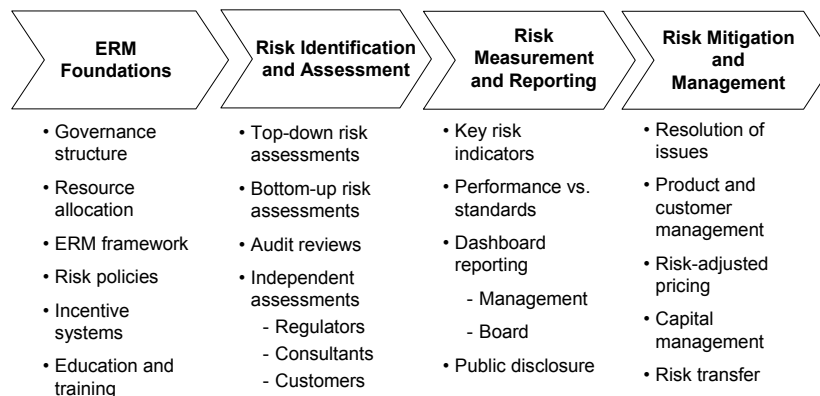
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## The four stages of an enterprise risk management process

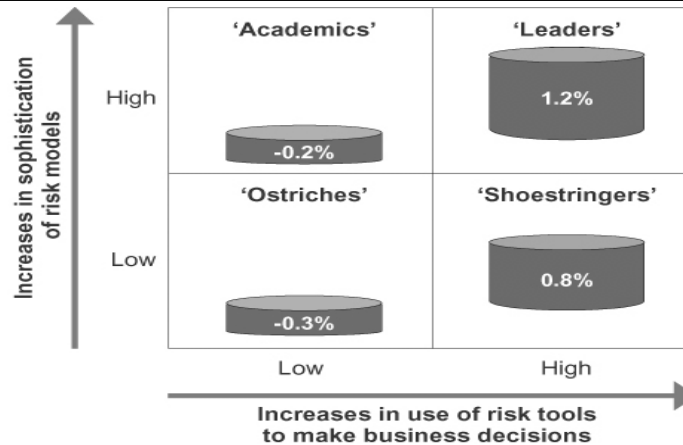
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## Early adopters of ERM have reported significant and tangible benefits

<u>Benefit</u>	<u>Company</u>	<u>Actual Results</u>
Market value improvement	Top money center bank	Outperformed S&P 500 banks by 58%
Early warning of risks	Large investment bank	Global risk limits cut by 1/3 prior to Russian crisis
Loss reduction	Top asset management company	Loss-to-revenue ratio declined by 30%
Regulatory capital relief	Large commercial bank	\$1 billion regulatory capital relief
Insurance cost reduction	Large manufacturing company	20-25% reduction in insurance premium

## Annualized total shareholder returns (1998-2003) for differing degrees of risk model sophistication and risk tool usage



Source: PA Consulting, 2004

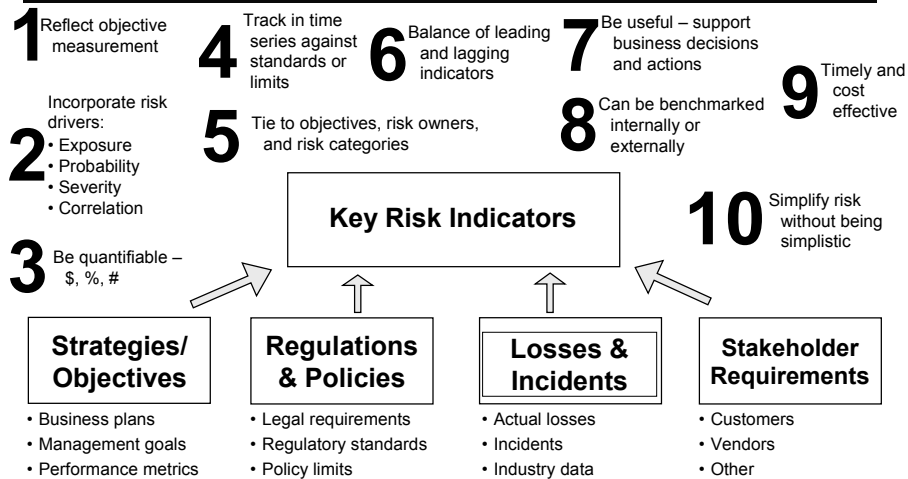
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## Characteristics and sources of effective key risk indicators

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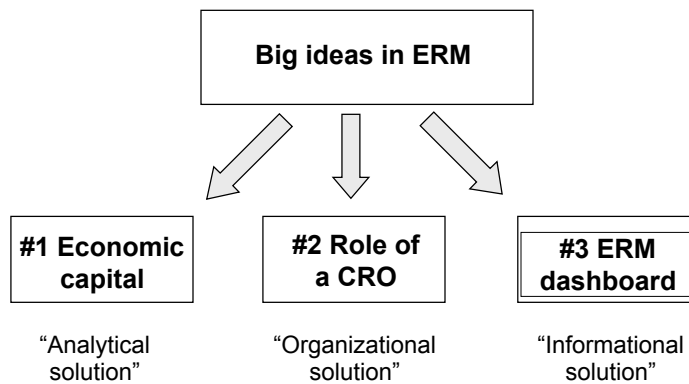
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4. **Don't produce volumes of data and reports – develop an ERM dashboard**

## The ERM dashboard – the next big idea?

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# An ERM dashboard should address five key questions for senior management

1. Are any of our strategic, business, and financial objectives at risk?
2. Are we in compliance with policies, limits, laws, and regulations?
3. What risk incidents have been escalated by our risk functions and business units?
4. What key risk indicators and trends that require immediate attention?
5. What are the risk assessments that we should review?

