

# How ERM Added Value To My Organization

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ERM

2006 ENTERPRISE RISK MANAGEMENT *Symposium*

## Implementing ERM



What are my risks?  
Who is watching them?



How much do they weigh?  
What is their impact



What can we do about them?  
How do we decide?



How do I take action?  
What value does it create?

ERM

2006 ENTERPRISE RISK MANAGEMENT *Symposium*

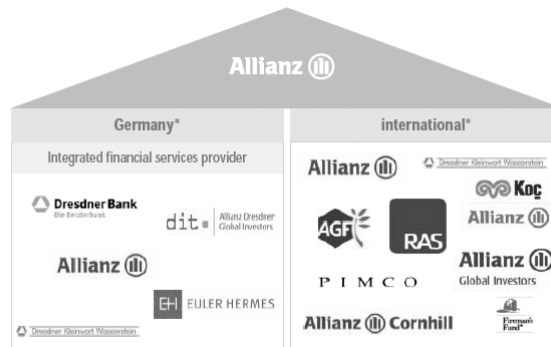
## How Enterprise Risk Management Adds Value at Allianz

The Society of Actuaries, CAS and PRMIA  
ERM Symposium April 25, 2006



A complex Group requires enterprise wide risk management

The Allianz Group - one company, multiple brands



### Allianz Group 2005 - Focus on profitable growth:

- Total revenues exceeded threshold of 100 billion Euros
- Operating profit exceeded expectations, rising 13.2 per cent to 7.7 billion Euros
- All targets exceeded: 30.7 per cent earnings growth; net income of 4.4 billion Euros

Allianz Group aims to protect the capital base and to support value creation by superior risk management

Key elements	
<b>Strengthening risk culture and awareness</b>	<ul style="list-style-type: none"> <li>▪ Risk adequate organization</li> <li>▪ Risk based strategy (risk tolerance/appetite)</li> <li>▪ Risk policy and minimum standards</li> <li>▪ Operational Risk Management (ORM) and Top Twenty Risk Assessment (TRA)</li> </ul>
<b>Protecting the capital base</b>	<ul style="list-style-type: none"> <li>▪ Internal risk capital</li> <li>▪ Capital stress tests</li> <li>▪ Life Asset-Liability-Management (ALM) and evaluation of options &amp; guarantees</li> <li>▪ Limit system</li> </ul>
<b>Supporting value creation and decision making</b>	<ul style="list-style-type: none"> <li>▪ Integration of risk/capital into management dialogue</li> <li>▪ Transaction/product analysis/review</li> <li>▪ Risk reward balance (risk based resource allocation)</li> <li>▪ Risk and capital reports</li> <li>▪ Pre-emptive risk decision and follow-up</li> </ul>

**Perform risk diagnostic to ensure implementation**

**“No Surprises” is the critical objective**

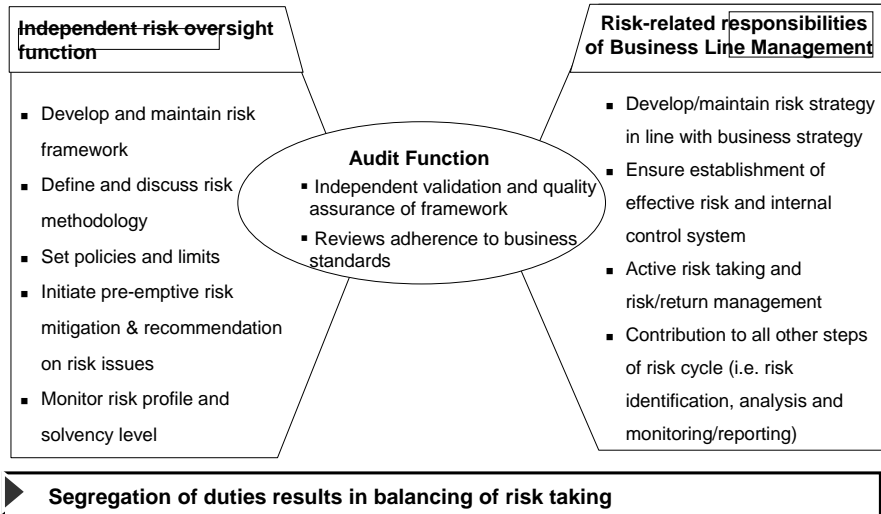
1. Strengthening risk culture and awareness

**Successful Risk Governance needs the right Risk Culture**

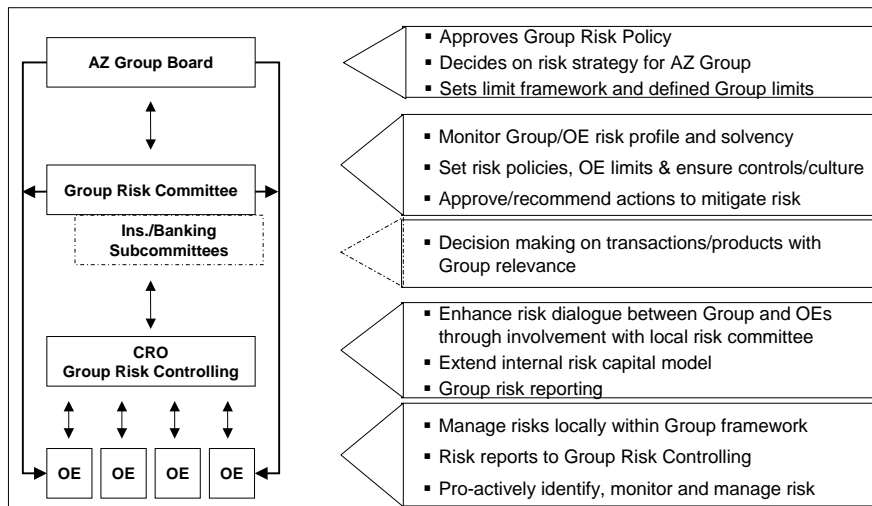
<b>Build the boat</b>	<p><b>Setting a consistent group-wide framework and develop a risk culture</b></p> <ul style="list-style-type: none"> <li>▪ Define Chief Risk Officer's role and focus to drive change throughout the organisation</li> <li>▪ Formalise CRO office to establish consistent group-wide risk management framework</li> <li>▪ Create senior level focus on risk issues by set-up of Risk Committee with decision making authority</li> </ul>
<b>Get people aboard</b>	<p><b>Convince key stakeholders and embed risk function and awareness</b></p> <ul style="list-style-type: none"> <li>▪ On-going discussion on risk &amp; capital development and emerging risk issues with each entity</li> <li>▪ Group-wide project to implement “Risk Management Minimum Standards” and Capital Stress Tests which were developed in co-operation with major subsidiaries</li> <li>▪ Introduction of peer review process for Risk Diagnostic</li> </ul>
<b>Set sail</b>	<p><b>Re-inforce risk culture and foster group-wide approach</b></p> <ul style="list-style-type: none"> <li>▪ Yearly CRO-Conference</li> <li>▪ Senior Level Risk Seminars</li> <li>▪ Active participation of Group CRO and staff in local Risk Committees</li> </ul>

**Strong risk culture is a prerequisite for balanced risk taking**

## Independent Risk Oversight is the key foundation for Enterprise Risk Management



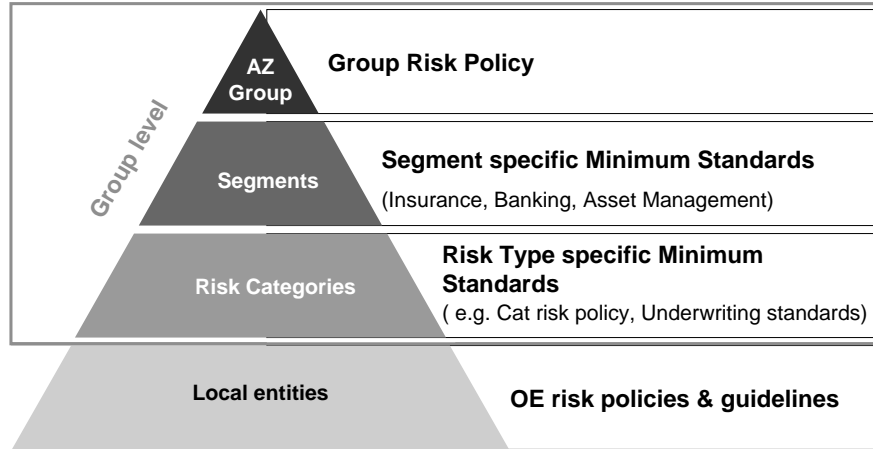
## The Allianz Group Risk Committee is the cornerstone for risk-related decision making at Group level



**Uniform framework for risk-related decision making on all levels of the Group**

1. Strengthening risk culture and awareness

The Group Risk Policy lays the foundation for consistent risk management for Allianz Group



**Group risk policies ensure consistently high standards for risk management and provide a framework for balanced risk taking**

1. Strengthening risk culture and awareness

Minimum standards form the basis for local risk management practice

Key Elements	Details
Risk-based strategy	<ul style="list-style-type: none"> <li>▪ Clear risk strategy to be defined in line with overall Group strategy</li> </ul>
Risk limits & policies	<ul style="list-style-type: none"> <li>▪ A limit framework must formalize the risk strategy</li> <li>▪ OEs must have in place documented policies for all risk-related processes</li> </ul>
Risk organisation	<ul style="list-style-type: none"> <li>▪ Senior risk committee oversees all OE risk activities</li> <li>▪ Independent risk oversight without direct P&amp;L responsibility</li> <li>▪ Group participation in local risk committees</li> </ul>
Risk processes	<ul style="list-style-type: none"> <li>▪ Tasks and decision authorities must be clearly defined and documented for all steps in the risk process (risk identification, analysis &amp; evaluation, management decision &amp; execution, monitoring &amp; reporting)</li> </ul>
Risk reporting	<ul style="list-style-type: none"> <li>▪ Holistic risk reporting (to cover all risk categories and exposures in all business areas)</li> </ul>
Risk methodology and tools	<ul style="list-style-type: none"> <li>▪ Local risk methodology to be defined within Group standards</li> <li>▪ Allianz risk capital tool as central steering parameter</li> <li>▪ Allianz stress test tool for regulatory and rating agency solvency mandatory for selected OEs</li> </ul>

**Segment-specific Minimum Standards add detail to the Group Risk Policy**

## ORM at Allianz aims to reduce losses and improve relevant processes

Key elements	
<b>Basis</b>	<ul style="list-style-type: none"> <li>▪ <b>Uniform definition and categorisation</b> as a basis for a common understanding of operational risk (based on Basel II)</li> <li>▪ Use of a <b>standard platform</b> for Operational Risk Management throughout Allianz</li> </ul>
<b>Approach</b>	<ul style="list-style-type: none"> <li>▪ Identification of process and control inadequacies and weaknesses via Structured Self Assessment</li> <li>▪ Collection of internal loss events as basis for the analysis and future risk capital integration</li> </ul>
<b>Implications</b>	<ul style="list-style-type: none"> <li>▪ Active risk management integrated in the day-to-day business</li> <li>▪ Ongoing process improvement based on bottom-up weakness analysis reducing operational losses over time</li> <li>▪ Quantification of operational risk capital based on internal and external data for the future</li> </ul>

▶ **Allianz is rolling-out a consistent approach over all business segments**

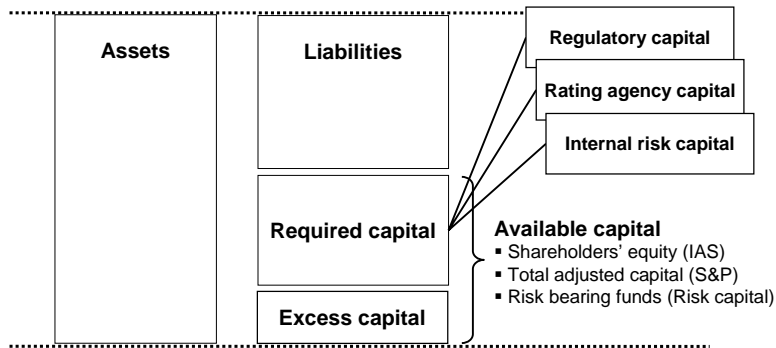
## Top Risk Assessment: What keeps management awake at night

Key Elements of Top 20 Risk Assessment
<ul style="list-style-type: none"> <li>▪ IT supported procedure to establish a sound risk culture and awareness within the Allianz Group</li> <li>▪ Structured identification and comprehensive assessment of all key risks (qualitative and quantitative risks)</li> <li>▪ Identification and prioritisation of appropriate risk mitigation activities and assessment of their effectiveness</li> <li>▪ Procedure to define risk tolerance level and bring actual risk profile in line with risk tolerance</li> </ul>

▶ **Qualitative assessment is in line with new requirements from regulators (APRA, FSA, BaFin)**

2. Protecting the capital base

There is no unique definition of required capital  
nor of available capital

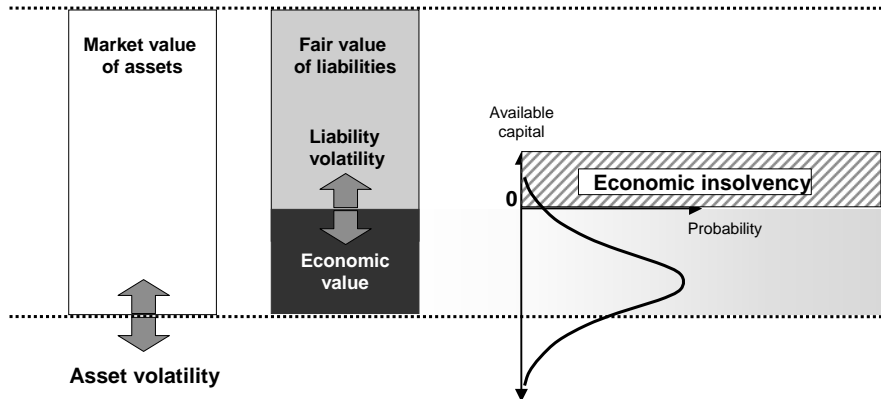


▶ Which definition to use for value based management?

2. Protecting the capital base

Risk is uncertainty about the future development  
of the economic value of the business

Available capital after one year

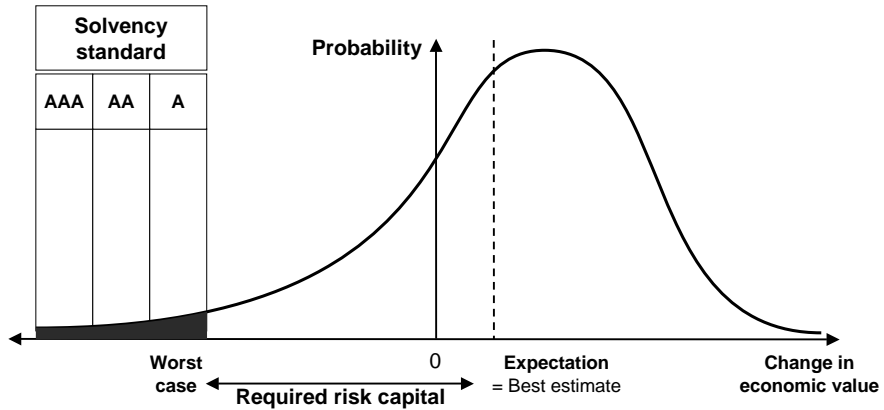


▶ Economic perspective is independent of accounting practice or regulatory requirements

2. Protecting the capital base

Common risk framework allows for consistent translation of risk taking into capital requirement

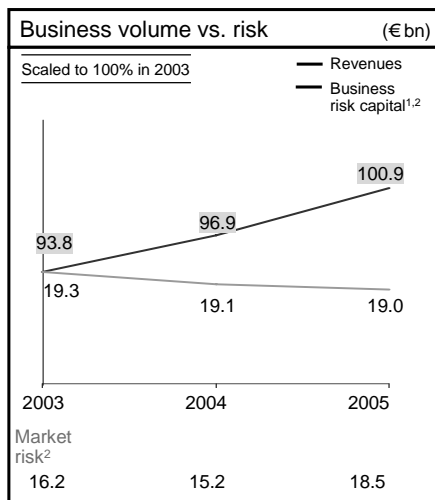
One year value at risk (VaR) approach



Risk capital is the minimum amount of capital required to ensure solvency over the course of one year with a certain probability which is linked to our rating ambition

2. Protecting the capital base

Application of Risk Capital framework: Active risk/return management resulted in more business with less risk



- Successful risk management: Risk profile actively managed, optimized diversification
- Successful de-risking allowed to take on more business
- Return on the risk taken has continuously improved

1) Risk capital contains following risk components: credit/counterparty, premium, reserve, life actuarial, business risk (excl. market risk)  
2) Before minorities

2. Protecting the capital base

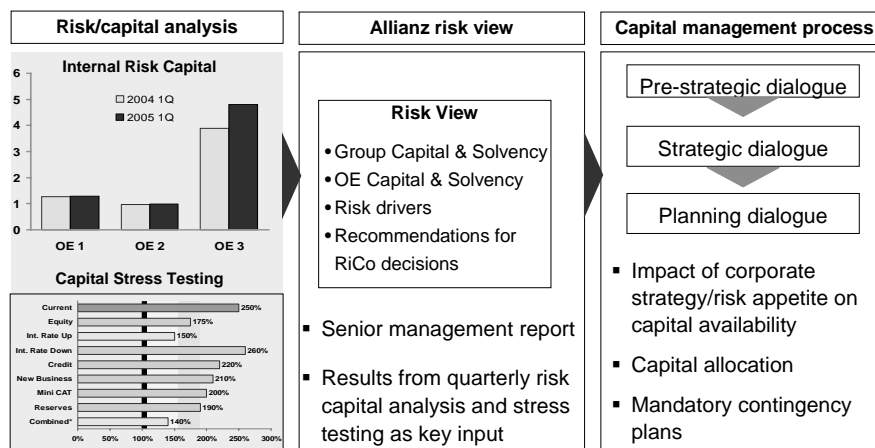
Stress tests on regulatory and rating capital complement the economic risk capital perspective

	Regulatory capital	Rating agency capital	Risk capital
<b>Perspective</b>	<ul style="list-style-type: none"> <li>Insurance Group Solvency</li> <li>Financial Conglomerate</li> <li>Local Solvency</li> </ul>	<ul style="list-style-type: none"> <li>Group Rating</li> <li>OE Ratings</li> </ul>	<ul style="list-style-type: none"> <li>Economic perspective</li> </ul>
<b>Approach</b>	<ul style="list-style-type: none"> <li>Internally defined stress tests e. g.                             <ul style="list-style-type: none"> <li>Equities - 30%</li> <li>IR up/down</li> <li>NatCat</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Internally defined stress tests e. g.                             <ul style="list-style-type: none"> <li>Equities - 30%</li> <li>IR up/down</li> <li>NatCat</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Internal risk capital model</li> </ul>
<b>Implications</b>	<ul style="list-style-type: none"> <li>Traffic-light based monitoring system</li> <li>Contingency plans to safeguard solvency</li> <li>Integrated into capital planning process</li> </ul>	<ul style="list-style-type: none"> <li>Traffic-light based monitoring system</li> <li>Contingency plans to safeguard rating</li> <li>Integrated into capital planning process</li> </ul>	<ul style="list-style-type: none"> <li>Value based Management (EVA)</li> <li>Capital allocation</li> <li>Risk management</li> </ul>

**Need for simultaneous risk & capital management for all segments under various perspectives increases management complexity**

3. Supporting value creation and decision making

Risk Capital and Stress Tests need to be fully integrated into business planning process



**Embedding risk management into existing business processes is a key to successful value based management**

2. Protecting the capital base

Comprehensive Group limit framework limits  
Group's maximum exposure

Types of limits	Group limits	OE limits set by Group
Solvency limits	Solvency target & corridor	
Capital budgets		OE risk capital limit
Concentration limits	Counterparty/obligor exposure limits	
Investment limits	Group-wide counterparty credit risk limit	
Nat Cat limits <sup>1</sup>	Group-wide Nat Cat limit	OE specific Nat Cat limits

Based on Risk Appetite










1) Under development

▶ Group-wide limits allow steering of business towards a risk/return balance

3. Supporting value creation and decision making

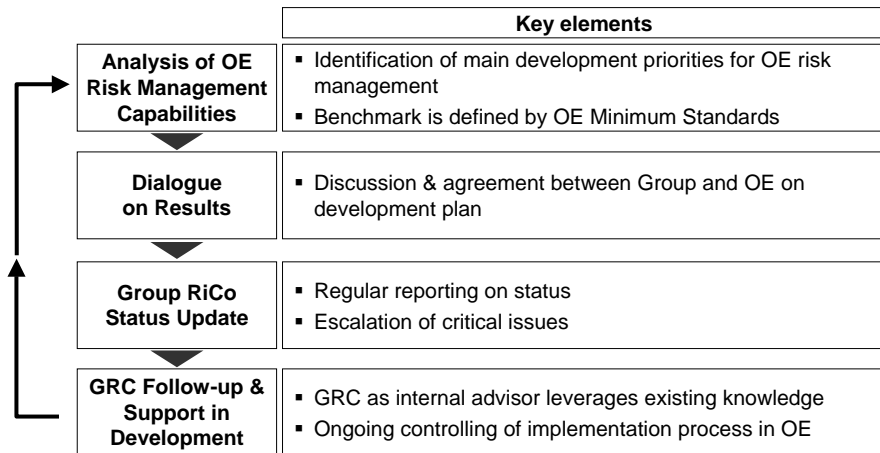
Reports highlight critical issues and facilitates senior management decision making

Example: Allianz Risk View – Executive summary of solvency level

	Risk capital	Rating Agency	Regulatory capital
Group	▪ Comment 	▪ Comment 	▪ Comment 
Segments	▪ Comment 	▪ Comment 	▪ Comment 
OEs	▪ Comment 	▪ Comment 	▪ Comment  <u>Illustrative</u>

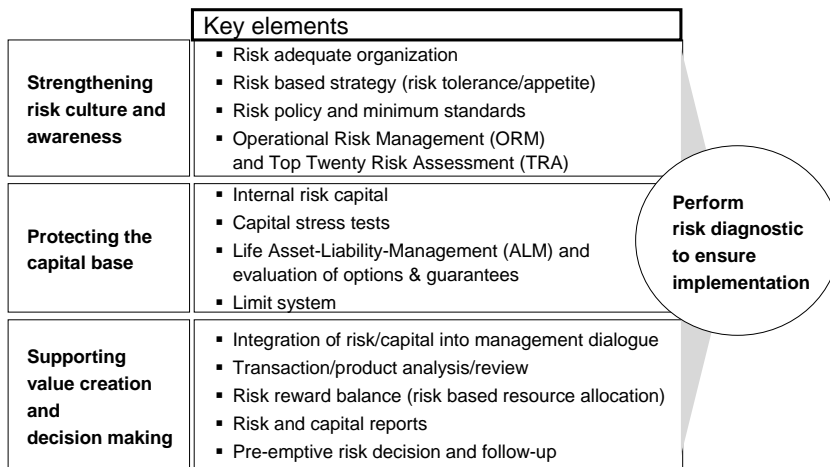
▶ Timely Risk/Capital reporting allows for pre-emptive risk management

Risk Diagnostic process is used to assess individual risk management capabilities on a yearly basis



**Senior management commitment is key success factor for development of OE risk management capabilities**

Allianz Group aims to protect the capital base and to support value creation by superior risk management



**Perform risk diagnostic to ensure implementation**

**ERM adds value by delivering on the objective of “No Surprises”**

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## Benefits of Enterprise Risk Management

Thomas C. Wilson  
General Manager, Corporate Insurance Risk Management

ERM Conference  
Chicago, 25 April, 2006

## Impact of ERM

Successful risk management organizations know what questions to ask ...



Communication  
& Confidence



- Is the institution's risk / return strategy transparent to external stakeholders such as shareholders / equity analysts, rating agency analysts, regulators, etc.?
- Are the markets correctly interpreting the institution's profile and applying the appropriate valuation multiple?

- Is the institution's risk profile consistent with the risk bearing capacity of its capital base and earnings?
- Are the rewards appropriate for taking the risks?
- Should the business model change, especially with regards to mitigation and intermediation strategies?

- Is the risk profile of the organization transparent and understood by management?
- Is the risk within delegated authorities?

- Are all transaction structured, underwritten and priced appropriately for their risk?
- Are all other risks identified and mitigated?