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Why Actuaries Can Make Bad CROs

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Agenda

- The main responsibilities of a CRO in a GI company
- How risk management adds value to the business
- The key areas of risk management that the board care about
- Where actuaries working in risk management tend to spend their time
- Why actuaries are often focussing on the wrong things and what to do about it

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Important caveat

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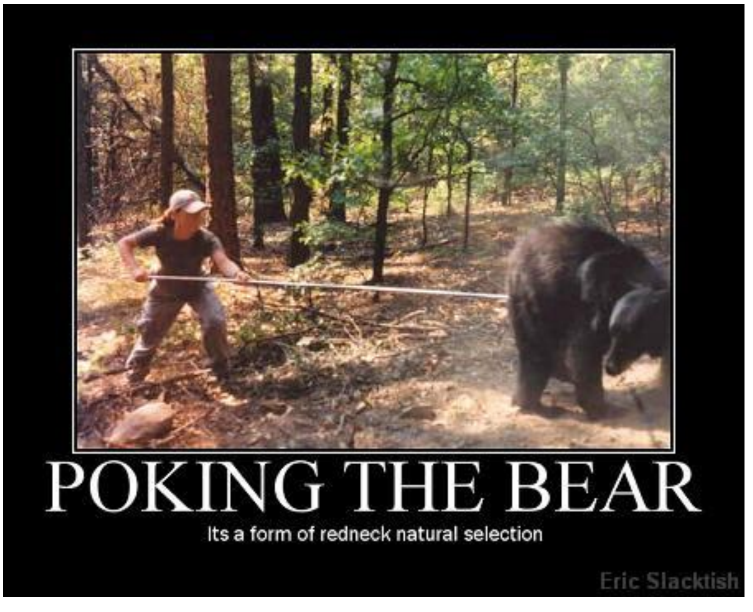

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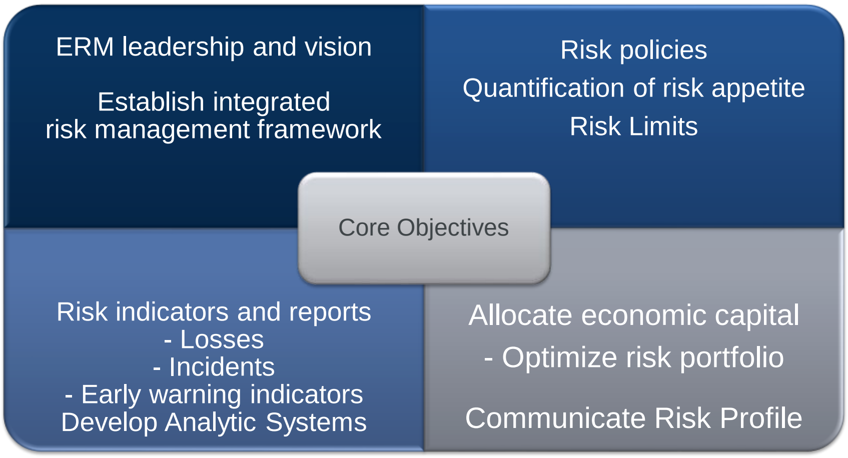
The main responsibilities of a CRO



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Source: Enterprise Risk Management: From incentives to controls - James Lam

How Risk Management Adds Value

- Companies make money by being prepared to take risks
- Risk Management should help improve the chances that the reward for taking risks is delivered
  - Defining Risk Appetite
    - What risks are you prepared to take, how much risk will you accept, what return do you need to make that risk worthwhile
  - Providing assurance that the business is within the approved risk appetite
  - Spotting when things are beginning to go wrong so that problems can be sorted early
  - Identifying risks and cost effective mitigation

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How you prove Risk Management adds value

- When things go well
  - First line management (underwriters) did a really good job
- When you stopped an initiative
  - You (usually) can't prove that the loss would have happened
  - The business will believe that it would have performed better if you hadn't got in the way
- When things go wrong
  - Why didn't you stop it before money was lost?
- Heads they win, tails you lose?

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The key areas of risk management the board cares about (?)

- How likely is it that we will deliver a profit / sufficient profit to keep key stakeholders happy?
- What can I do to make this profit more certain?
- Is my rating safe? Is there anything I can do to make it better / avoid deterioration?

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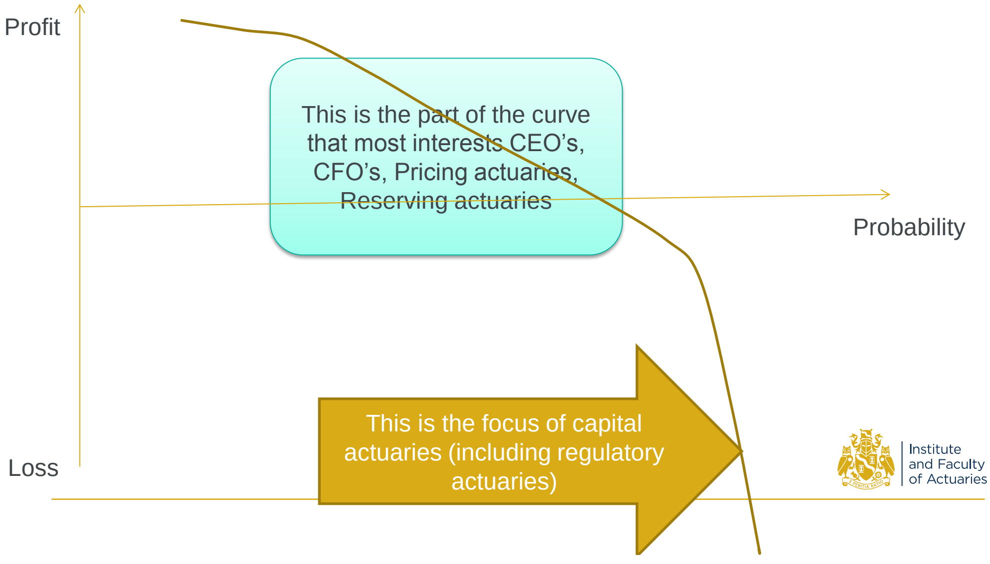
The key areas of risk management the board cares about



Null Hypothesis

- Actuaries are attracted to parts of their role that involve
  - Quantification / Numbers
  - Mathematical models
  - Analysis of data
  - Financial measurement and projection
- Stereotypes
  - Communication skills may be weaker than peers
  - Social skills ditto

ERM leadership and vision

- What is ERM going to look like for your company?
- How are you going to get there from where you are now? What is your strategy ("cunning plan")
- How are you going to make a 2nd line of defence valued – particularly in an industry that believes that it earns it's keep by good "risk management"
- The vision you are implementing may not be your own (Predecessor? Eiopa? Consultant? Group Head Office?)

Potential Pitfall
- over prioritisation of quantitative tools
- Risk management function focused on Capital as the ultimate mitigant

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Establish Integrated Risk management framework

- Governance - how can the board be confident that it will all work
- Define appropriate checks and balances
- The most important work is done by the first line (Risk Takers) – framework should enable them to know how much "flexibility" they have
- Classic risk management control cycle should probably be incorporated here

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Risk policies
Quantification of risk appetite
Risk Limits and Thresholds

Requires excellent written communication skills

- Risk Policies – how expect company to behave
- Risk appetite
  - If you took no risk, then you will get a risk free return
  - What risks are you prepared to take, and how big are they, to enable you to make a return in excess of risk free

More than capital required

- Risk thresholds and limits is the point at which the risk framework really begins to impact on day to day life
  - Normally pretty established for underwriting – less well understood for other risks
  - A lot of work to establish

Need to obtain buy-in from business

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Risk indicators and reports
- Losses
- Incidents
- Early warning indicators

- This is the monitoring part of the risk management cycle
- Early warning indicators – should be there to show you that something is starting to go wrong, or that the environment is changing in a way that makes a risk more likely to crystallise
- Losses and incidents are a vital part of the learning process for an organisation

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Allocate economic capital - Optimize risk portfolio

- Optimize your risk portfolio – good
- Doesn't have to be at the level of capital (although that is clearly a big factor)
- Believe your model so much that you try and use it for arbitrage – maybe less good

Potential Pitfall
- Actuaries are extremely comfortable in this space
- the danger is that too much effort is focused here, and not enough time on areas that are more of a stretch

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Develop analytic systems - Data management to support

- This goes hand in hand with risk indicators and reports
  - What do you need to be looking at
  - If you haven't got the data available, how can you get it

Potential Pitfall

Actuaries always want more data to analyse, and may waste too much time trying to find it, when good insight may be gained from
- Qualitative reviews
- Subjective knowledge base within company
- Thinking about what can go wrong and contingency planning to mitigate risks

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Communicate Risk Profile

- Risk profile implies looking at the range of probabilities
- Capital is a means to an end (regulatory approval, customer confidence and rating agency) not an end in itself

Particularly in smaller firms, the CRO can be the "buffer" between the firm and the regulator

- Requires good communication and negotiation skills

It is vital that the board receives appropriate risk training to be effective and fulfill their role

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What to do about it!

- Think about your strengths and weaknesses, what interests you, what you want to do
  - Build up a team that complements you, not a team of mini-me's
  - What training/development do you need
- Plan how to spend your time
  - Allow a disproportionate amount of time for bits you don't like?
- Get out of your comfort zone
- Remember it is not all about capital
- The fact that a risk is not easily measured does not make it go away

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

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