



Financial Crisis Puts Spotlight on ERM

Sixth Biennial Global Enterprise Risk Management Survey

Discussion of Key Findings

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Agenda

- Survey background
- Key findings
- Selected supporting data

Towers Watson has conducted its sixth biennial survey on Enterprise Risk Management in the insurance sector

- During the second quarter of 2010, Towers Watson conducted a web-based survey among senior executives in major insurance companies around the world
- Chief risk officers, chief financial officers and chief actuaries were asked to document the approaches to, and current status of, ERM activity within their companies
- This is the largest survey of the insurance industry on its topic; over two-thirds of the total 465 insurance executive respondents were C-suite
- Respondents include a wide range of insurance organizations from North America (31%), Europe (21%), Asia Pacific (19%) and multiple regions (28%)
- Respondents come from all lines of business, including life insurance (37%), property & casualty (P&C) insurance (29%), multiline insurers (18%) and reinsurance (13%)

Geographical terms

- North America: U.S., Canada and Bermuda
- Europe: U.K. and continental Europe
- Asia/Pacific: Asia and Australia
- Latin America: Mexico and South America
- Middle East/Africa: Middle East and Africa

Company size terms

- Large: Annual revenue in excess of U.S. \$10 billion
- Medium: Annual revenue between U.S. \$1 billion and \$10 billion
- Small: Annual revenue less than U.S. \$1 billion

Key Findings

Our 2010 insurance ERM survey produced six key findings

- 1. ERM performance during the financial crisis was mixed.** While 58% of participants were satisfied with their ERM capabilities' performance during the global financial crisis, 42% were neutral or dissatisfied.
- 2. Risk appetite is important to ERM success.** Companies with a documented risk appetite statement are more likely to be satisfied with the performance of their ERM capabilities than those lacking one (66% versus 47%).
- 3. The business impact of ERM continues to grow.** Ninety-two percent of respondents indicate that their ERM program has resulted in key business changes, compared to 78% in 2008.
- 4. Resource availability is challenging ERM development.** People challenges were noted as the greatest challenge to ERM implementation (cited by 56% of participants).
- 5. Convergence of economic capital methodology has slowed.** While a one-year risk assessment period continues to be most popular overall (68% of participants), only 49% of P&C insurers use this approach.
- 6. Solvency II proves challenging in Europe, but its influence is spreading.** Only one in 10 European respondents believe their internal models currently meet the approval requirements; 38% cite the "use test" as the most challenging aspect.

Selected Supporting Data

ERM Performance and Priorities

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ERM PERFORMANCE AND PRIORITIES

The majority of participants indicated that they were satisfied with how their ERM capabilities performed during the financial crisis

Q1. How well did ERM capabilities perform during the financial crisis of the last 18 – 24 months?

Dissatisfied/
Very Dissatisfied
11%

Neutral
31%

Satisfied/
Very Satisfied
58%

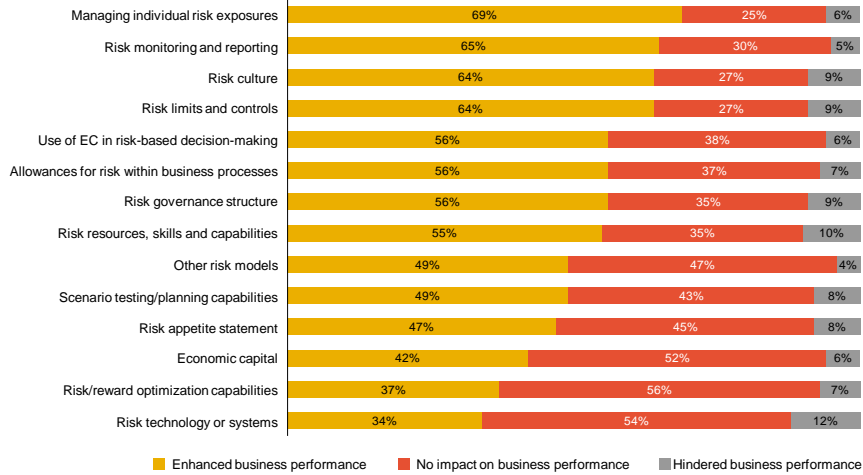
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Core risk-control techniques and strong risk culture did most to enhance business performance during the financial crisis

Q2. Based on your experience over the last 18 – 24 months, how would you characterize the contribution of the following risk management areas?



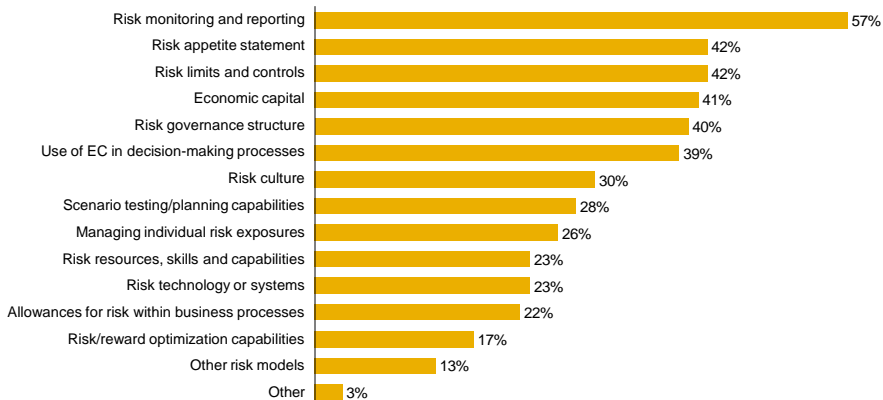
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Short-term priorities emphasize risk control processes, risk appetite, economic capital modeling and use of EC in decision-making

Q3. What are your ERM development or improvement priorities for 2010 – 2011? Select up to five.



For European insurers, risk appetite (57%) and economic capital (52%) are the focus of future improvements

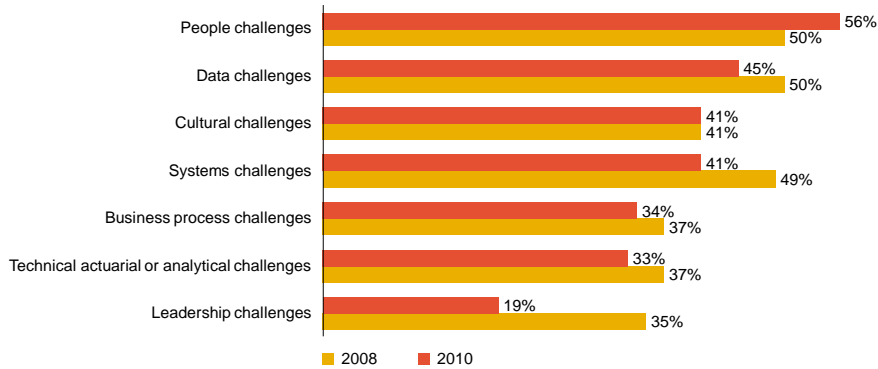
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Finding the right resources continues to be a challenge

Q4. Which are the greatest challenges in implementing ERM over the next year? Select up to three.



Ninety-two percent of respondents indicated that key business changes have resulted from their ERM activities in the past two years

Q5. Over the past two years, what key business changes have resulted from your ERM program?



Risk Management Governance and Organization

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RISK MANAGEMENT GOVERNANCE AND ORGANIZATION

Generally, overall risk responsibility ultimately lies with the full board or a designated subcommittee

Q6. Is the full board or a board subcommittee charged with the overall risk responsibilities?

Entity	Percentage
Full board	35%
Separate risk committee	36%
Audit committee	14%
Multiple subcommittees	8%
Finance or investment committee	4%
Other	3%

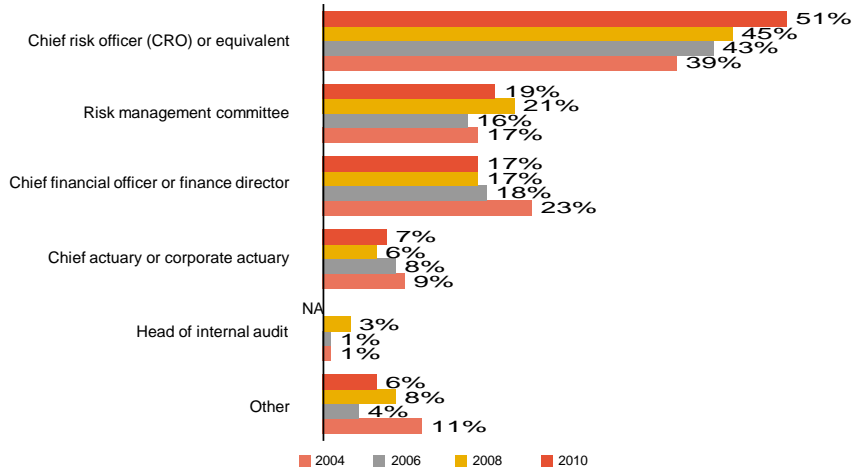
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Continuing a historical trend, CROs are most commonly appointed to direct and facilitate their company's risk management efforts

Q7. Who, below the board of directors, is primarily responsible for risk management in your organization?



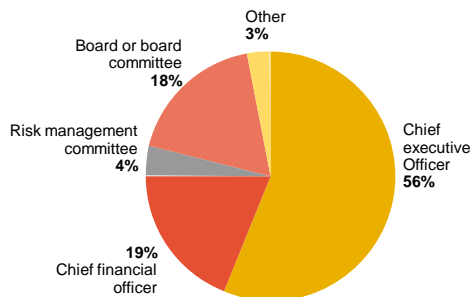
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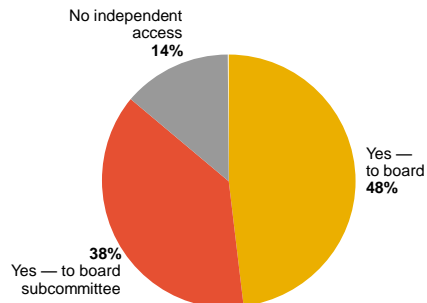
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The majority of CROs report directly to the CEO and nearly half have direct access to the board

Q9. To whom does the CRO or equivalent primarily report?



Q10. Does the CRO or equivalent have independent access to the board or to a board subcommittee?



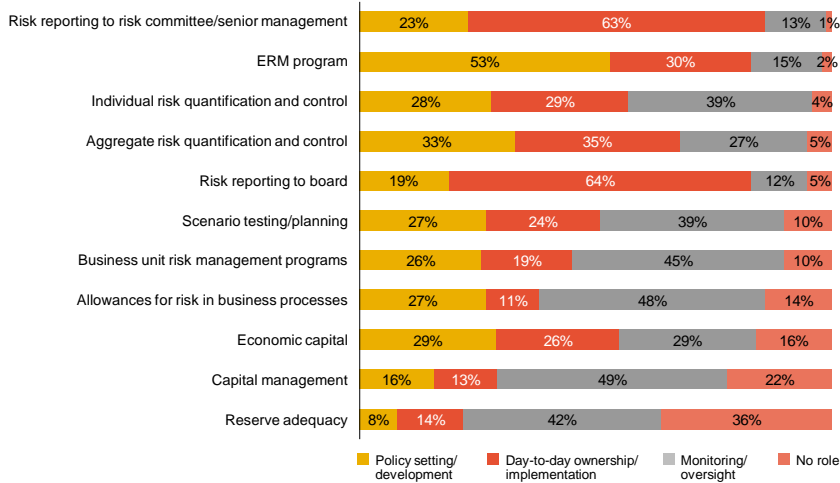
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The CRO typically sets the high-level policy for the ERM program, executes risk reporting and has a broad risk oversight role

Q11. Which set of terms best describes the role that the CRO or equivalent plays?

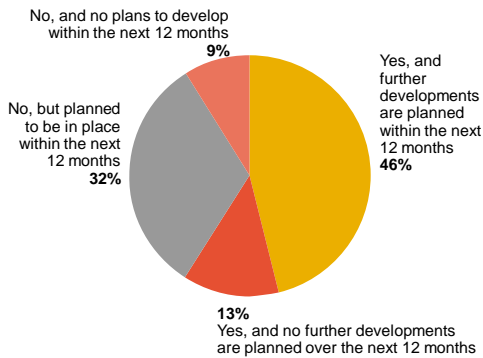


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Risk Appetite, Limits and Reporting

The proportion of respondents who have a documented risk appetite has increased from 47% in 2008 to 59% in 2010

Q12. Do you have a documented risk appetite/tolerance statement?

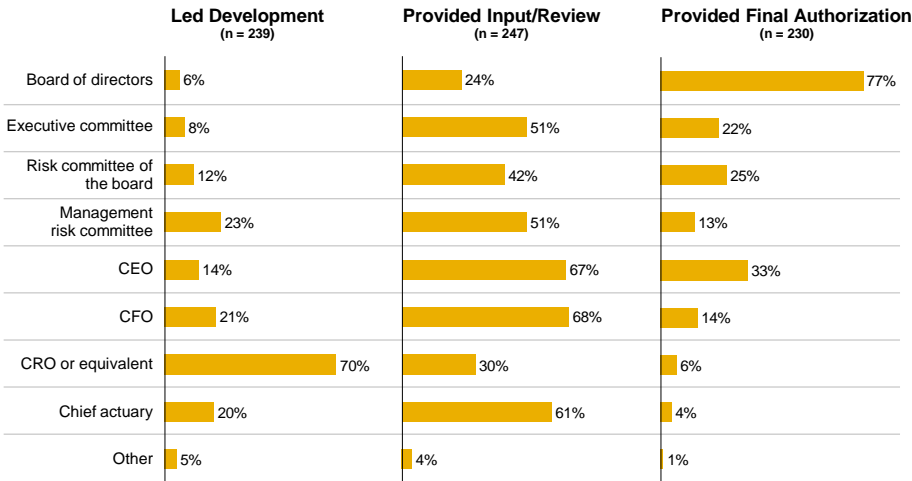


	Total In Place or Planned	
	2008	2010
Small	78%	88%
Medium	89%	91%
Large	91%	100%

- Having a documented risk appetite varies widely by region, with Europe (70%) ahead of Asia Pacific (61%) and North America (52%).

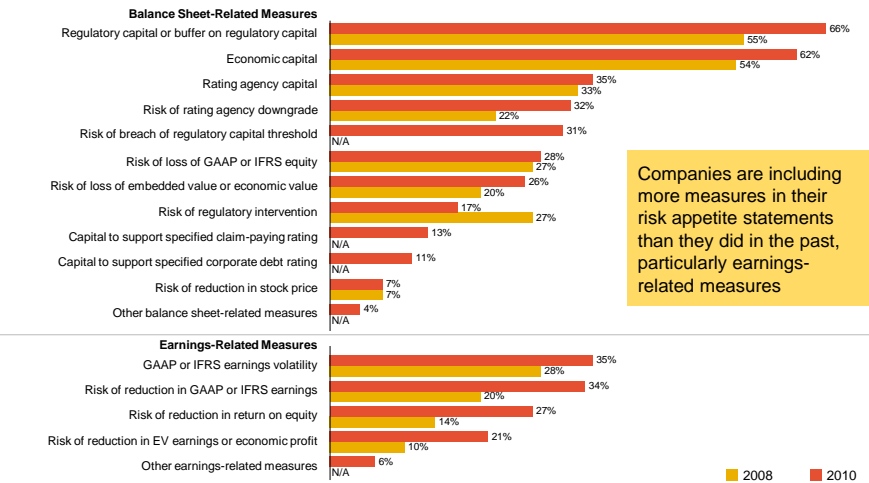
Development of risk appetite is typically led by the CRO, takes input from many areas of the company and is authorized by the board

Q13. Who was involved in the development and approval of the current overall risk appetite statement?



Balance sheet solvency remains the principal focus of risk appetite statements

Q14. Which of the following measures of risk are used in your risk appetite/tolerance statement?

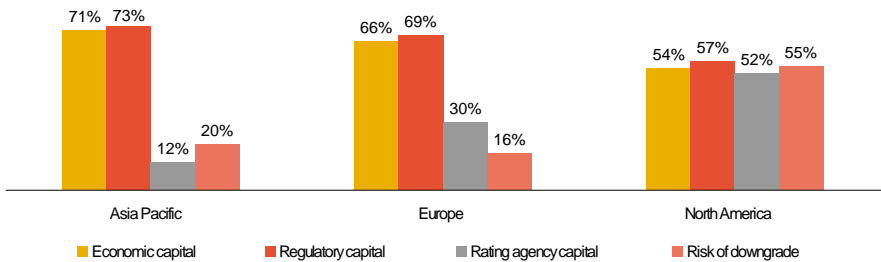


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Regulatory and economic capital are the key metrics used in risk appetite statements across each of the major regions

Q14. Which of the following measures of risk are used in your risk appetite/tolerance statement?



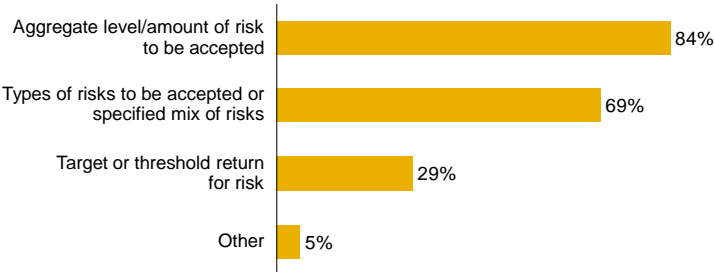
- Earnings-related metrics are not used as frequently as balance sheet-related metrics
 - They are most popular with large companies, where 54% monitor the risk of reduction in GAAP or IFRS earnings and 46% monitor GAAP or IFRS earnings volatility
 - They are also used more frequently with stock (public) companies, where 41% monitor risk of reduction in GAAP or IFRS earnings, compared to 18% of mutual companies

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Many companies specify the desired type or mix of risks within their risk appetite statement (as well as the aggregate risk exposure)

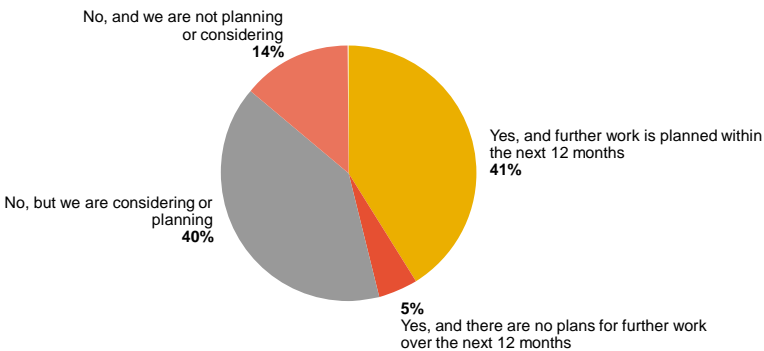
Q15. Which of the following aspects does your risk appetite statement cover?



- Small companies (78%) are more likely to include types of risk to be accepted or a specified mix of risks in their risk appetite statement than medium (66%) or large (54%) companies
- Life insurers' risk appetite statements are least likely (19%) to cover target or threshold return, while reinsurers' statements are most likely (43%) to include this

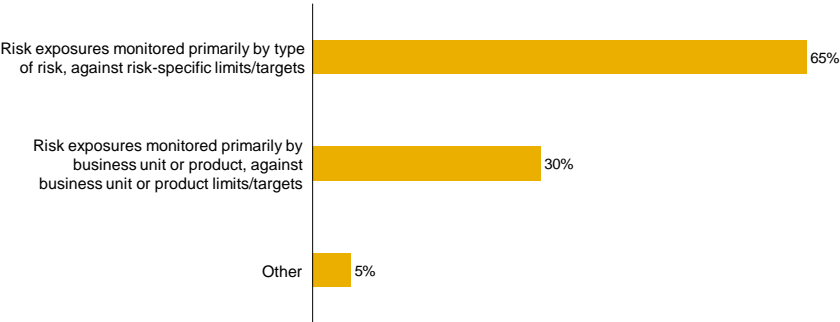
Companies are increasingly recognizing the importance of consistency between their risk limits and their risk appetite

Q18. Have you demonstrated/modelled the consistency of your bottom-up risk limits with your top-down risk appetite/tolerance statement?



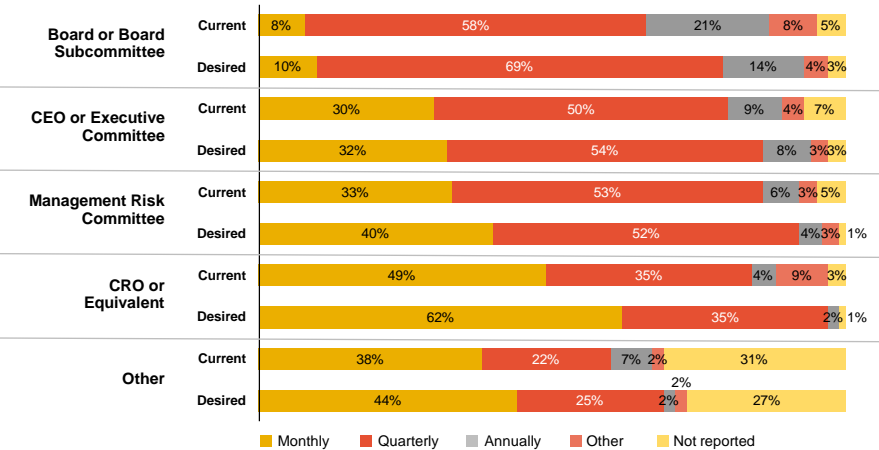
Companies predominantly monitor exposure by risk type, rather than by business unit or product line

Q19. What is the primary line of reporting for risk exposures against limits, at the level immediately below the overall appetite statement?



There is a general desire to increase the frequency of reporting of risk against risk appetite, in particular reporting monthly to CROs

Q20/21. At what level and frequency is risk exposure against risk appetite reported and monitored?



The risk appetite statement significantly impacts decisions about asset strategy and capital management

Q22. Within which business processes is risk appetite explicitly referenced or monitored? Please select all that apply.

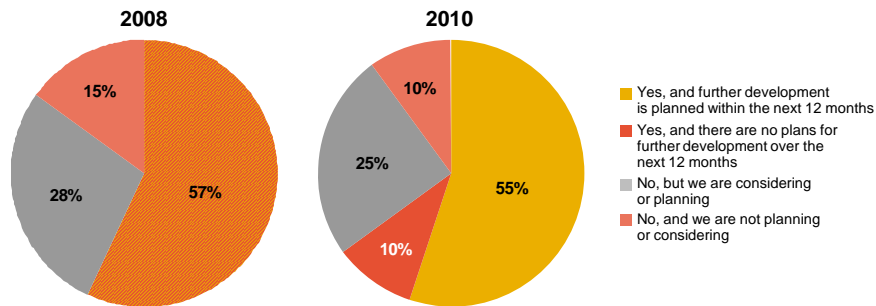


- 87% of life insurers monitor risk appetite for asset and liability management (ALM) purposes, compared to 78% of multiline, 64% of reinsurers and 42% of P&C insurers

Economic Capital Methodology and Use

The proportion of respondents calculating EC has increased from 57% in 2008 to 65% in 2010

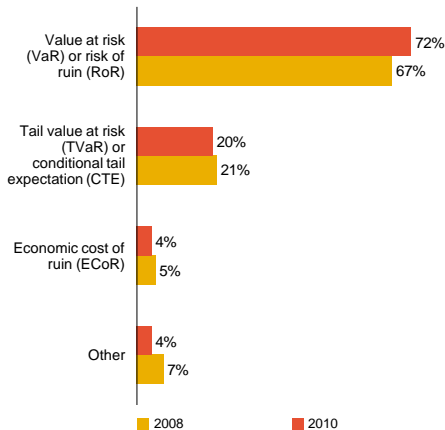
Q24. Does your organization calculate Economic Capital?



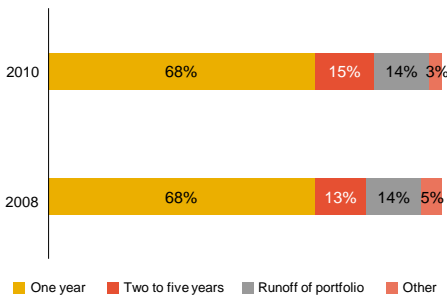
- Insurers in Bermuda (92%), Europe (84%) and Japan (81%) are more likely to calculate EC than their Asia Pacific (excluding Japan) (58%), Canadian (55%) and U.S. (49%) counterparts
- A large proportion (85%) of the companies calculating EC are planning further development within the next year

Convergence of EC methodology has slowed; differences in approach persist

Q26. What primary measure of risk tolerance do you use to calculate EC?

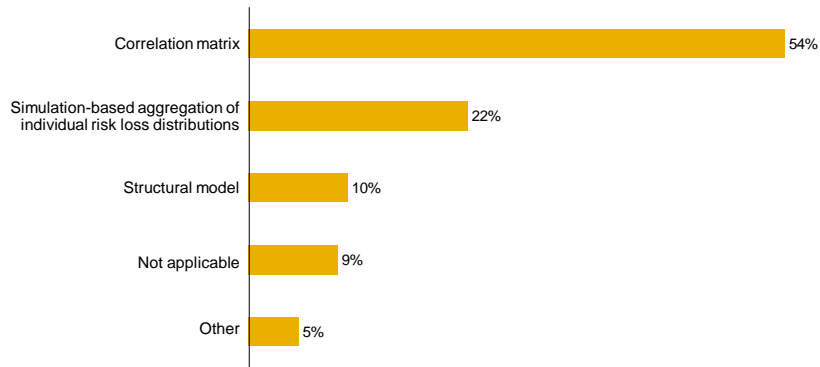


Q27. Over what period do you assess risk in calculating EC?



More than half of respondents prefer methodologies using correlation matrices rather than more complex simulation-based aggregation approaches

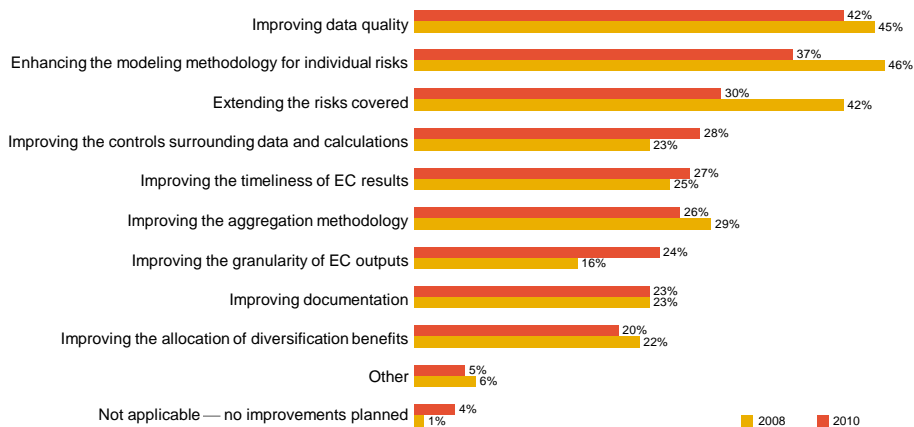
Q29. What methodology do you use for aggregating risk at the corporate level?



- Life insurers (72%) and multiline companies (57%) are typically using correlation matrices
- However, P&C companies somewhat favor simulation-based aggregation (35% use this approach, compared to 34% using correlation matrices)

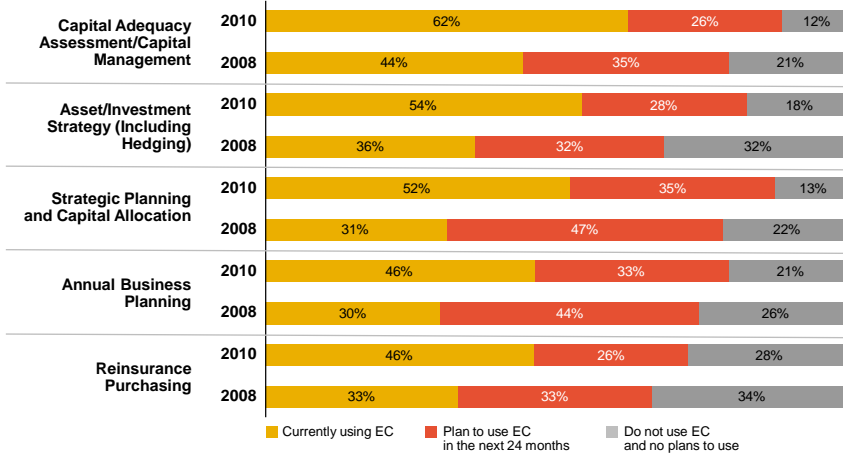
Ninety-six percent of respondents calculating EC have plans to develop or improve their framework in the next 12 months

Q30. What are your primary objectives for future improvements, if any, to your EC calculations and/or framework? Please select up to three.



EC is increasingly becoming a useful tool in influencing significant management decisions...

Q32. Do you currently use EC in decision making for the following areas?



- Current and planned utilization is still higher in Europe than North America or Asia Pacific
- The proportion of respondents who are using EC in 2010 is significantly less than was predicted in 2008

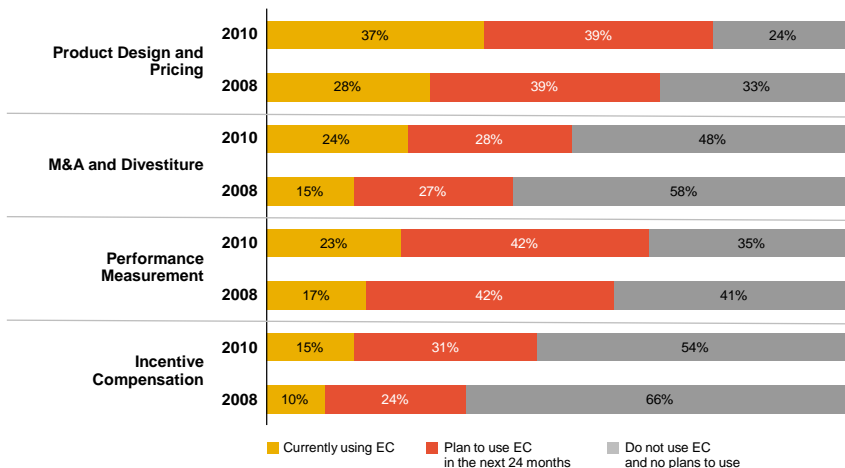
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...but use of EC in incentive compensation remains limited

Q32. Do you currently use EC in decision making for the following areas?



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Solvency II

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SOLVENCY II

As Solvency II has evolved, a significantly greater number of insurers are now expecting it will result in higher capital requirements

QS2. What effect do you expect Solvency II to have on the level of capital your business is required to hold?

2010

54%11%20%15%

2008

31%19%27%23%

2006

14%16%36%34%

Expect increase

Expect reduction

Expect little change

Unsure of impact

As might be anticipated (given diversification effects), small and medium-sized companies are more likely (58%) to expect an increase than large companies (39%)

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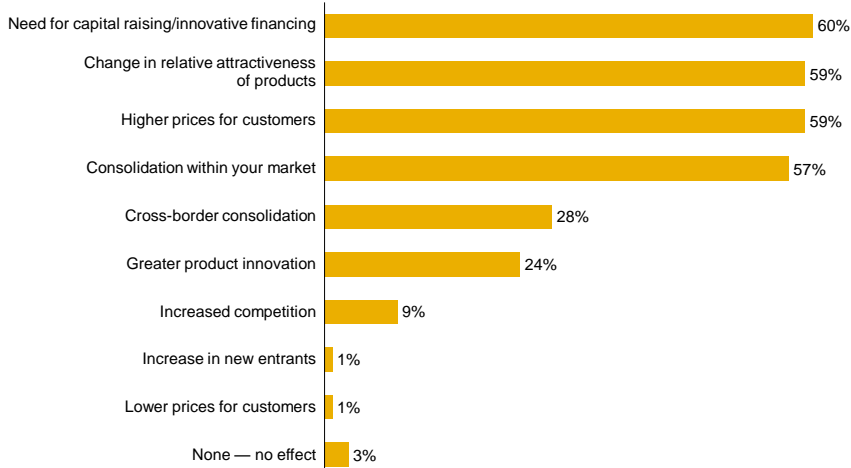
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Solvency II is expected to dramatically change many aspects of Europe's insurance marketplace

QS3. What do you believe will be the main effects of Solvency II on your market?



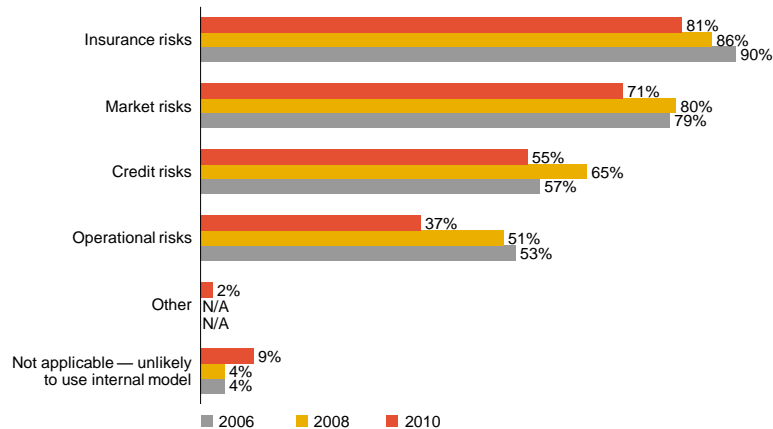
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While the vast majority of European respondents still expect to use internal models, planned utilization is down since 2008

QS4. For which type of risks are you likely to take advantage of the ability to use internal models?



- Expected use varies by size of company, with 100% of large companies, 94% of midsize companies and 83% of small companies expecting to use internal models for one or more risks

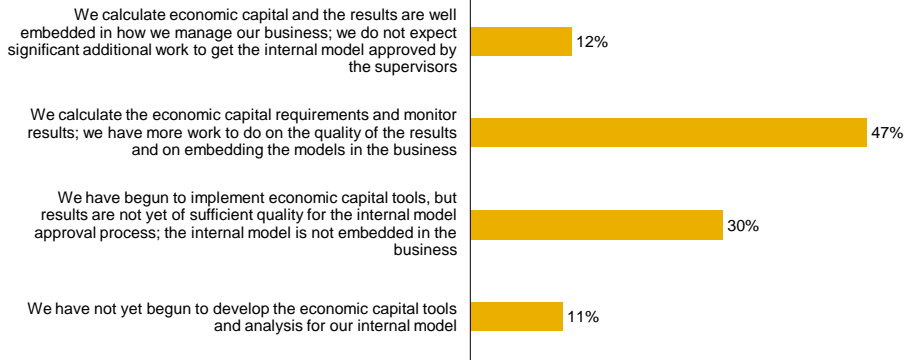
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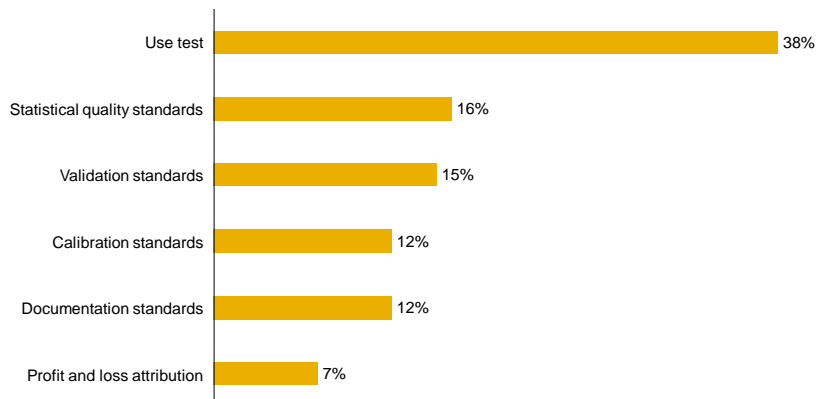
The majority of companies recognize that considerable work remains to be done if their internal models are to gain regulatory approval

QS5. Which of the following best describes the current state of your internal model development?



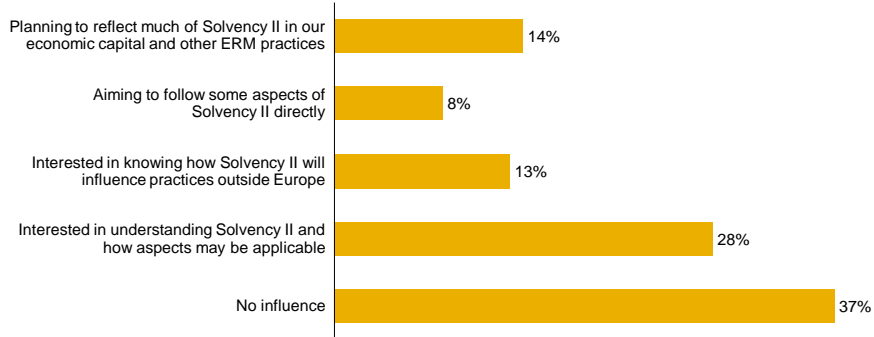
The “use test” is seen as the most challenging regulatory approval requirement across all sizes of companies

QS6. Which of the following requirements do you see as the most challenging area for achieving internal model approval?



Insurers outside Europe are following Solvency II developments, and some are reflecting its approaches in their ERM frameworks

Q38. Even though Solvency II does not apply to you directly, to what extent are you recognizing Solvency II regulation in developing your ERM practices?



- Thirty-five percent of respondents in Asia Pacific aim to reflect some aspects of Solvency II in their frameworks
- P&C companies outside Europe are least interested in Solvency II, with 53% of respondents indicating it will have no influence on their business