

GIRO conference and exhibition 2010

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Risk Management

Relying on Others – the CRO Perspective

12-15 October 2010

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- Role of Risk Management – independent or integrated
- Role of Senior Management and Boards
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- What goes wrong?
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Role of Risk Management

- Pre-emptive, independent and empowered
 - but also embedded, effective and aligned with company strategy
 - Group wide horizon
 - Comprehensive
 - Honest and clear
- ≡ Requirements at every level both internally and externally

Board and Senior Executives

Setting the tone

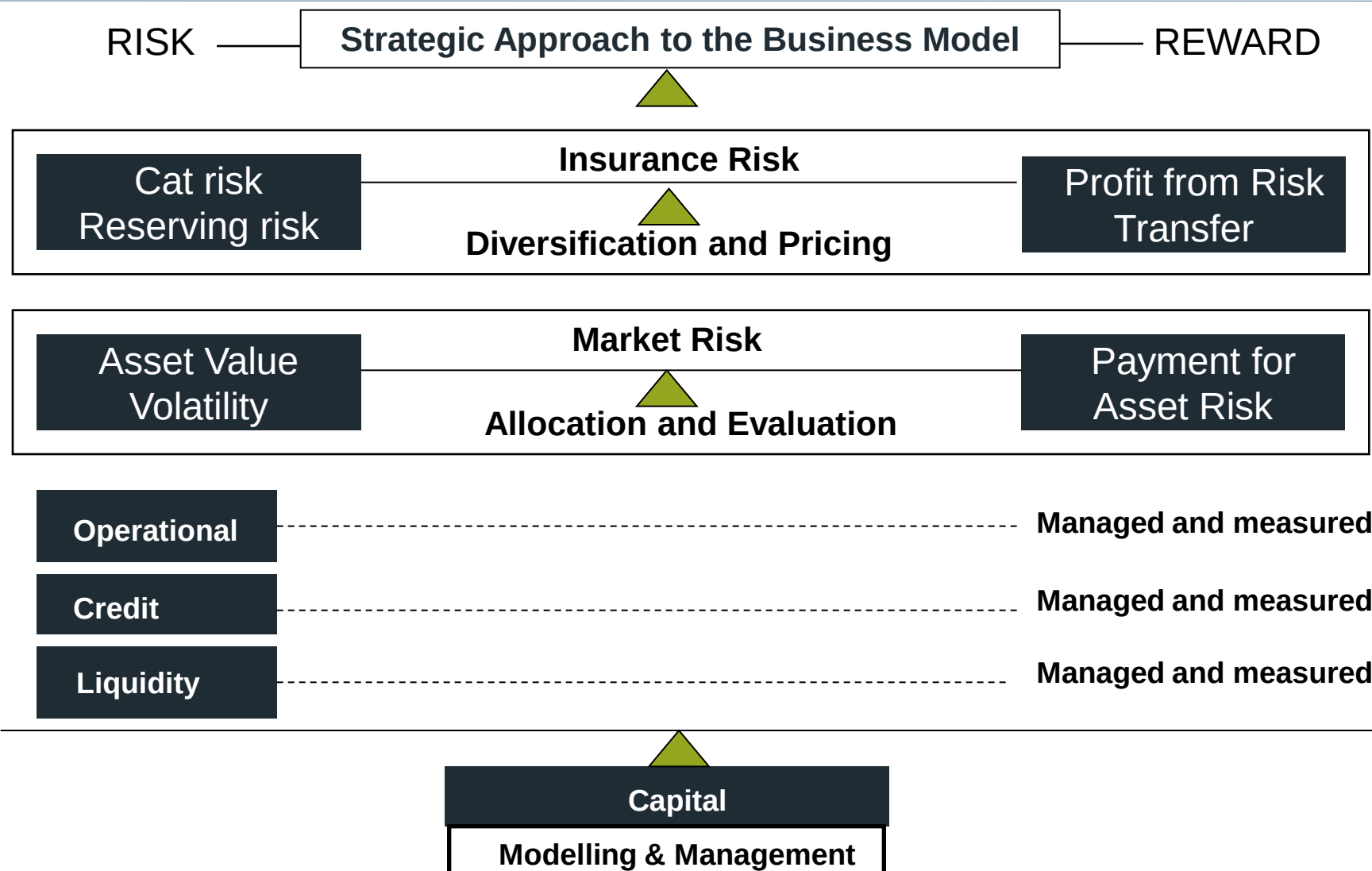
- Sponsorship of approach
- Transparency of model
- Core basic principles or values must be in place
- Ethos and culture

Strategy

- Strategic approach to business model with a firm view of risk and reward
- Performance targets must be commensurate with risk
- Compensation cannot be the problem
 - Risk based
 - Deferred
 - Alignment with other stakeholders
- Structures of governance in risk taking, control and assurance

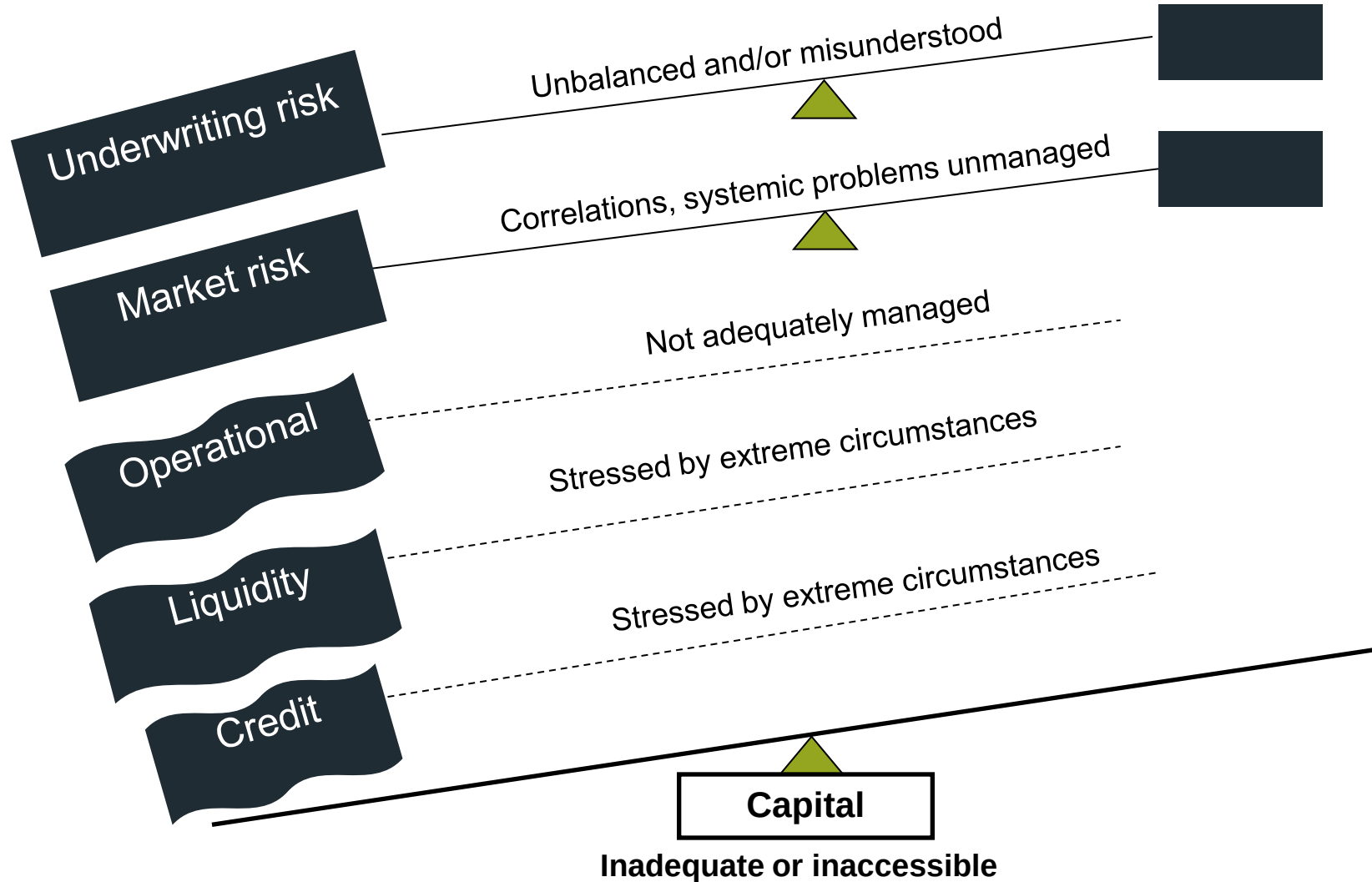
Guardianship of the Business

Model of Risk v Reward



Guardianship of the Business

What goes wrong:



What goes wrong

Tail events



What goes wrong

Fresh circumstances



Business Model will be stressed

1980

- 1981-82 Recession
- 1982-85 Latin American Debt crisis
- 1983-86 US Liability crisis
- 1987 Black Monday
- 1988 Piper Alpha
- 1989/91 Bond market collapse + Drexel failure
- 1989 San Francisco Earthquake
- 1989/91 US savings and loans crisis

1990

- 1990-91 UK Recession Mortgage Indemnity Crisis
- 1992 Hurricane Andrew
- 1998 Russian crisis and LTC

Business Model will be stressed

2000

- 2000 Dot Com bubble bursts
- 2001 Independent, Reliance, HIH liquidations
- 2001 WTC
- 2002 Legion Insurance fails
- 2005 KRW
- 2007-2009 Banking crisis, AIG bail out

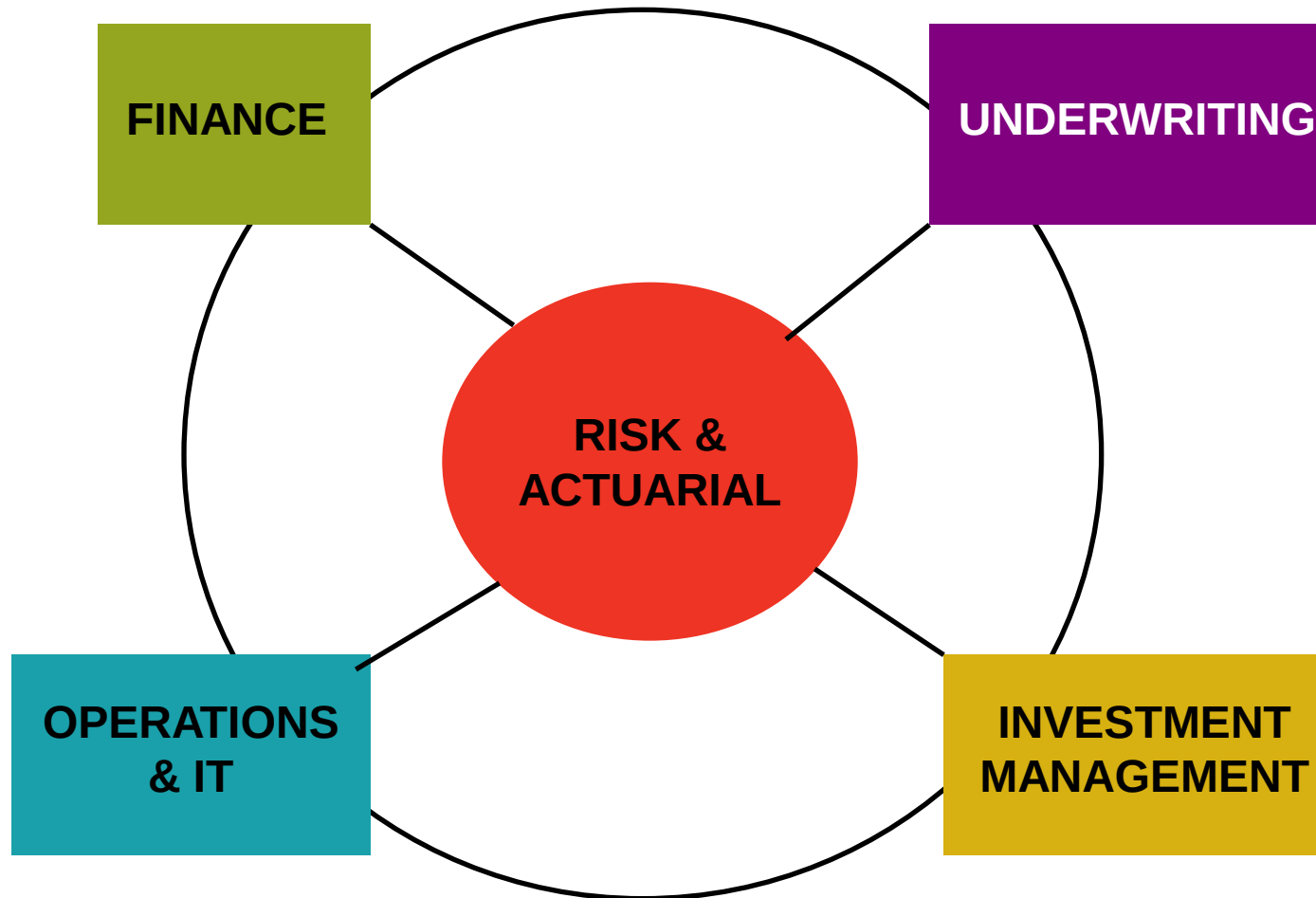
2010

- 2010 Sovereign debt crisis

Lessons from the past

- Careless, carefree or crooked
- Man's ingenuity can also be his downfall
- Risk taking rewarded and valued higher than risk control or assurance
- Ingrained instability in global financial system
 - Short termism
 - Reward for RoE
 - Contagion from systemic risk
 - Models are dangerous – reliance on ex-post

Roles in Managing Risk – internal structure



What do we need?

- Good data
 - Underwriting
 - Investments
 - Financial performance and forecasting
 - Sound systems and support
- Good models to support underwriting and investment expertise
- Good actuaries
 - Model building and population
 - Risk and reward management information
 - Good advice on use of model
 - Practice over theory
- Validation of framework and its output
- Common sense and restraint

Economic models role

- Must be embedded in framework
 - Must be independently produced but real world
 - Examined and understood by risk takers
 - Not a substitute for line guides, exposure limits or stress testing
 - Subject to review and validation
- ≡ Used for business planning, valuations, capital adequacy and allocation, risk analysis, reinsurance buying and maybe even pricing

External Support

- Risk experts to develop tools
- Actuarial support for evaluation, validation and building internal expertise
- Audit and risk consultancy to develop best practice
- Project managers!

External Stakeholders

Relying on common sense:

- Regulators
 - Avoid pro-cyclicality and unexpected consequences from regulation
- Governments
 - Recognise benefits of insurance for the economy
 - Recognise insurance as a different industry to banking
- Rating Agencies
 - Understand business model and mistrust Utopian solutions
- Professional Trade Associations
 - Support the industry and avoid needless overheads
- Investors and their advisers
 - Understand the sector and adjust expectations accordingly