



Institute  
and Faculty  
of Actuaries

# Risk and Investment Conference 2013

Brighton, 17 – 19 June





Institute  
and Faculty  
of Actuaries

# Plural rationality

How it explains regulators management and strategy of insurers

Alice Underwood, Willis Re  
Elliot Varnell, Milliman

ertise  
ponsorship  
Thought leadership  
Progress  
Community  
Sessional Meetings  
Education  
Working parties  
Volunteering  
Research  
Shaping the future  
Networking  
Professional support  
Enterprise and risk  
Learned society  
Opportunity  
International profile  
Journals  
Support

20 June 2013

# Group and grid

high “grid”  
hierarchy and status  
differences

<p>“my vote doesn’t matter” “roll with the punches” “who knows what’s next?”</p>	<p>“a place for everything” “command and control” “listen to the experts”</p>
<p>“survival of the fittest” “live free or die” “pioneer spirit”</p>	<p>“tread gently on the earth” “share and share alike” “a true leader serves”</p>

low “group”  
individual  
takes priority

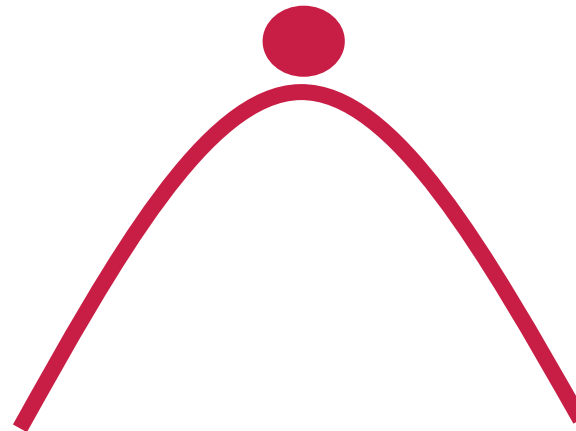
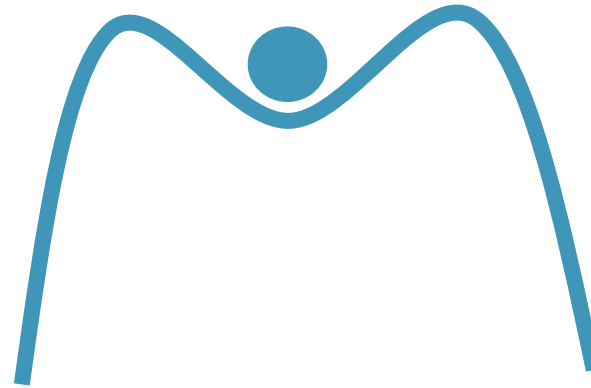
high “group”  
the group  
takes  
priority

low “grid”  
no org charts or castes



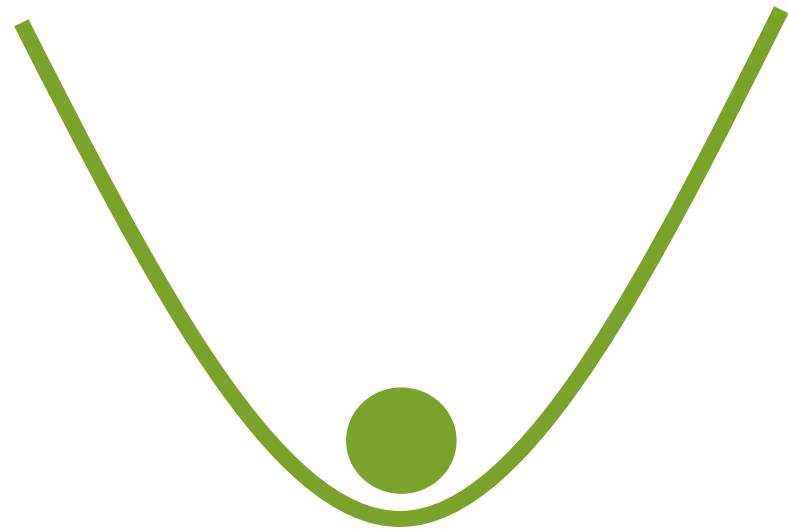
Institute  
and Faculty  
of Actuaries

# Four views of risk



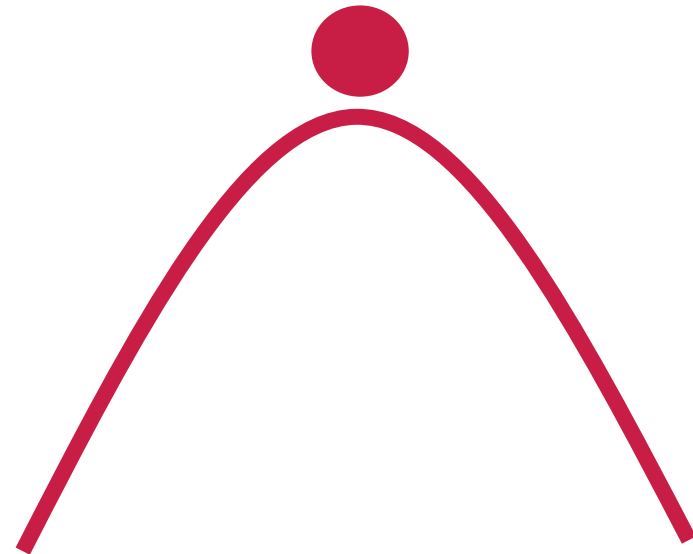
# Maximizers' view

- Risk is not very important – **profits** are important
- It's fine to accept large risks, as long as the price is right
- Risk is mean reverting:
  - Gains will always follow losses
  - The best companies will have larger gains and smaller losses over time
- **Risk trading** ERM strategy



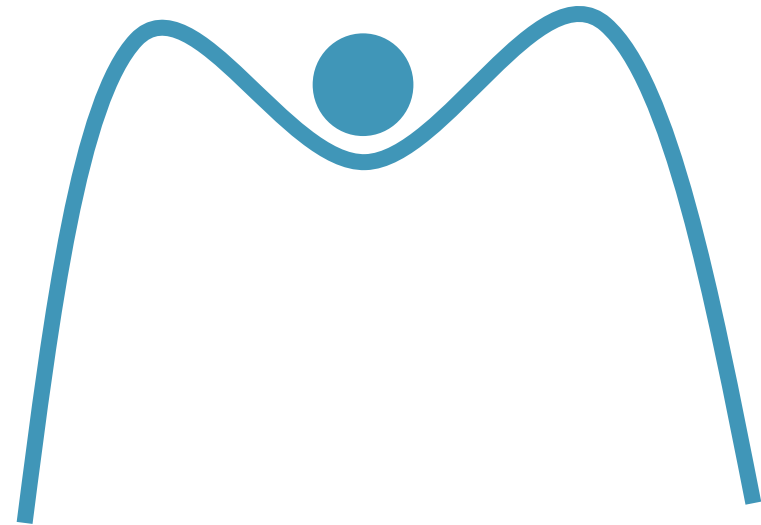
# Conservators' view

- Increasing profit is not as important as avoiding loss
- Need to **tightly limit** risks
- The world is in a delicate balance
  - Any major change could send things into ruin
- **Loss controlling** ERM strategy



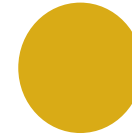
# Managers' view

- Risk is measurable and controllable
- Risk and reward should be **carefully balanced**
- Experts are best suited to
  - Help find risks offering the best rewards
  - Manage these risks to keep firm safe
- **Risk steering** ERM strategy



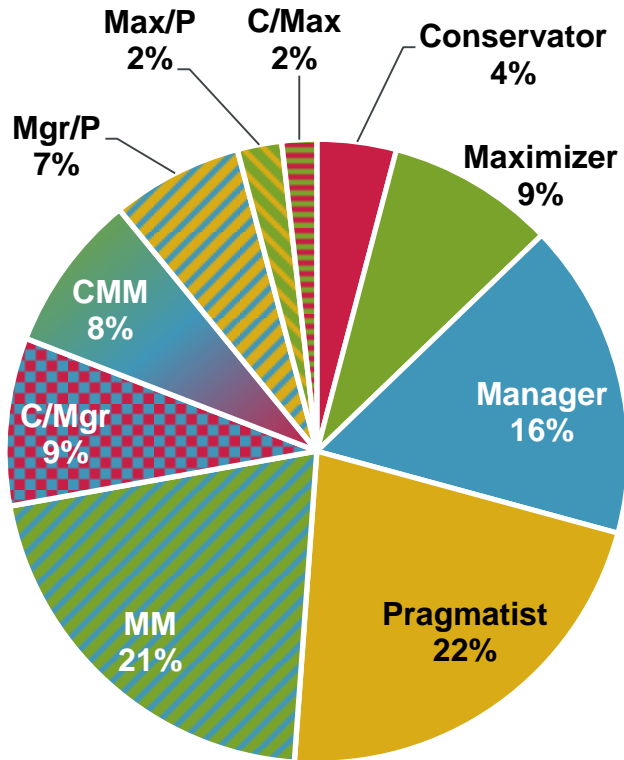
# Pragmatists' view

- The future is totally unpredictable
- You can't control risk so there is no point in trying
- It is usually best to
  - Avoid major commitments
  - Keep options open
  - Seek **freedom to react** to changing conditions
- **Diversification** ERM strategy





# Survey results

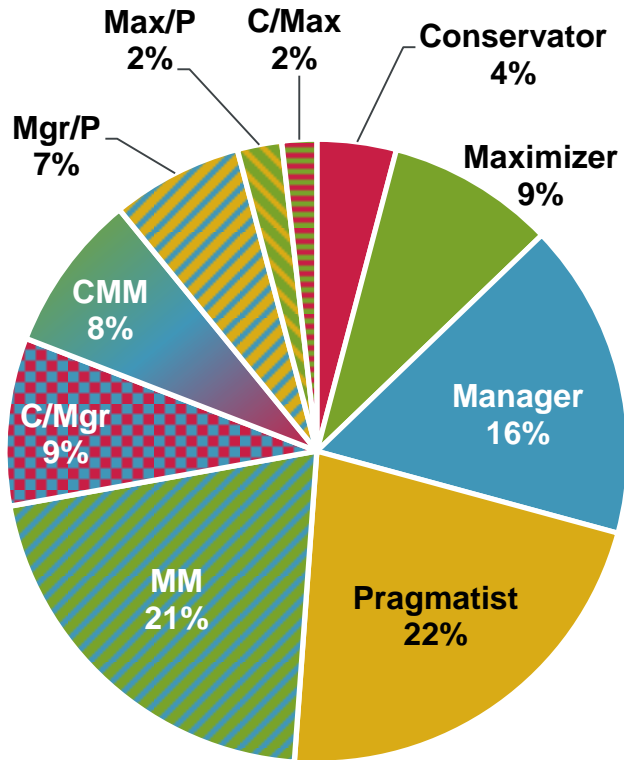


**Cumulative results:  
all insurance executives**

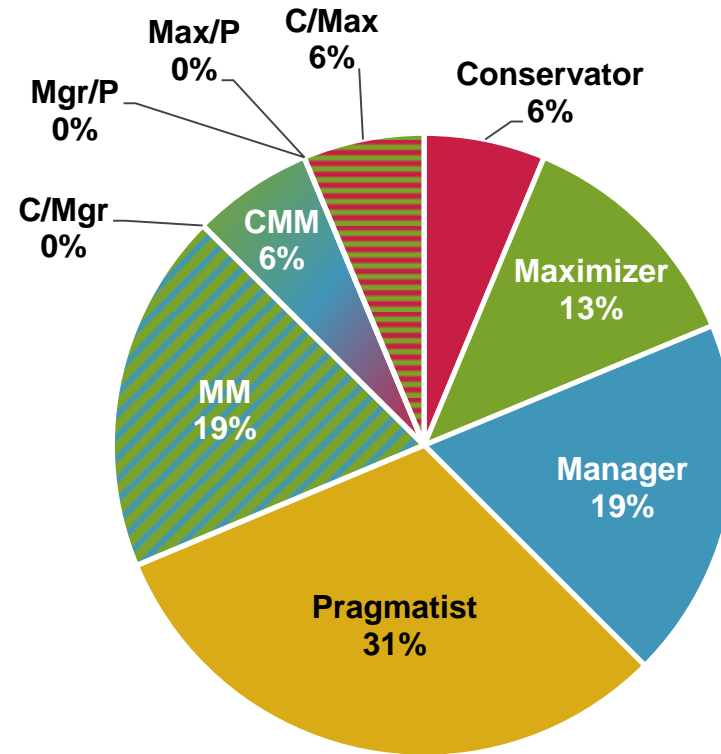
- About half of respondents identify with more than one view
- Plurality of these are “MM”
  - Works within a hierarchical organization and very much aligned with a profit maximizing objective for that group
  - Fairly aggressive in risk taking, but within some limits
  - Believe in systematic risk management, but don’t let it get in the way when a very profitable deal is on the table



# Survey results



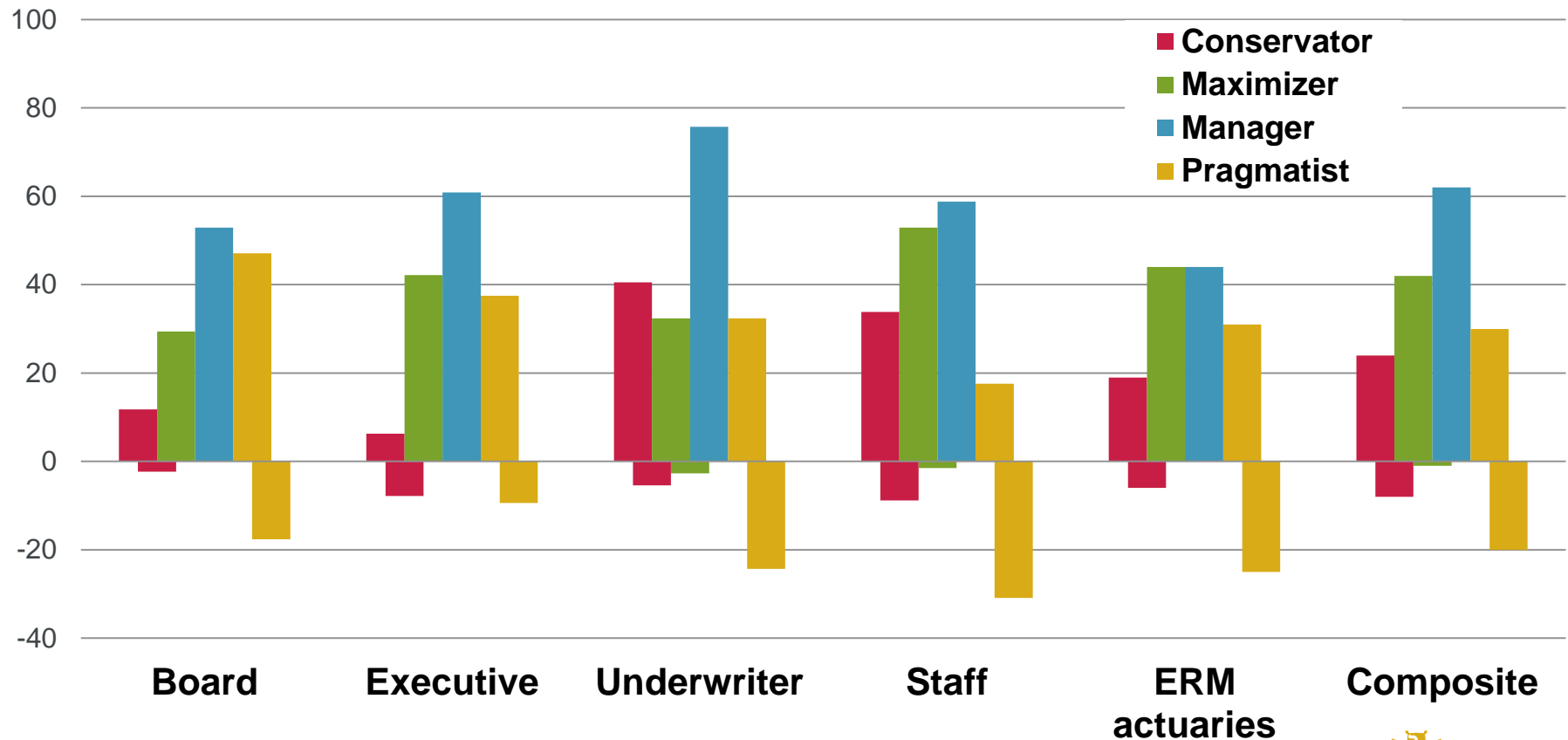
**Cumulative results:  
all respondents**



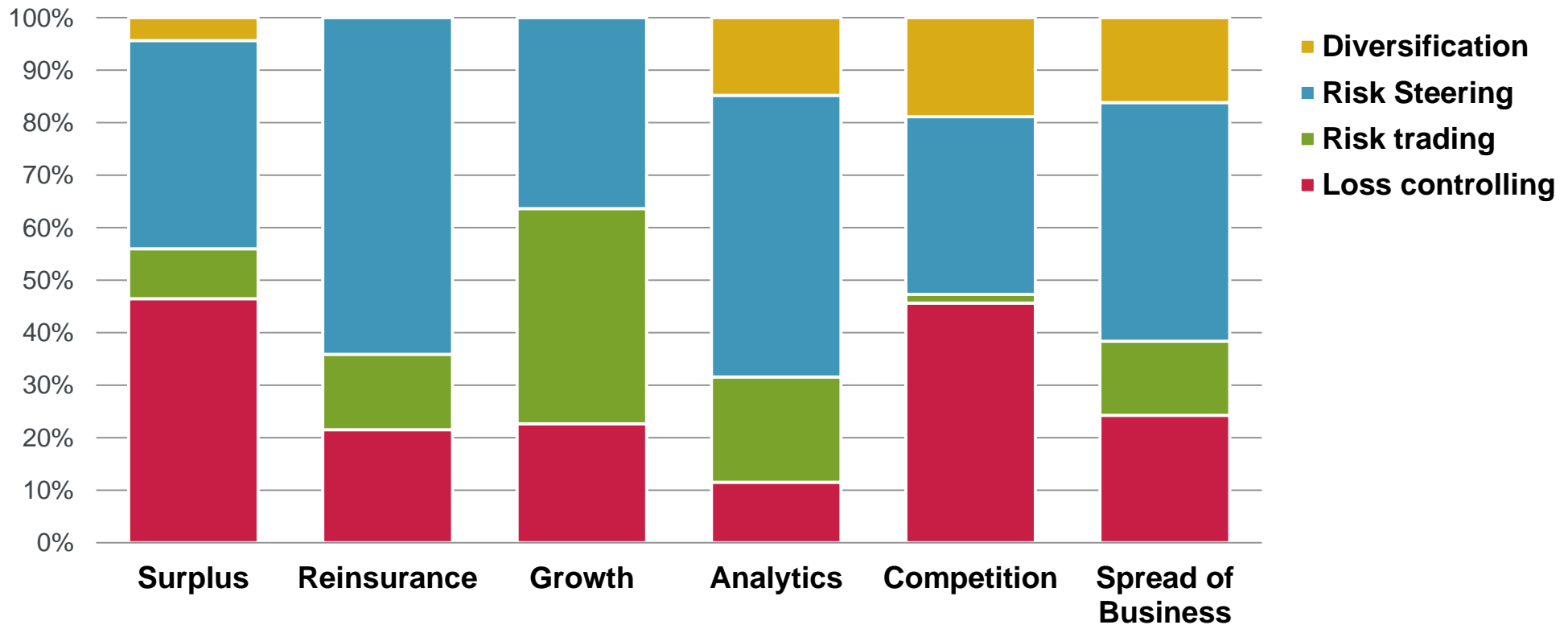
**Sample of experienced  
ERM actuaries**



# Agreement and disagreement by job function



# Preferred strategies for different risk types: sample spanning 23 companies



# The Regulatory Community

## How did it start?

- Suggestion to use these ideas to look at the regulatory community actually came from a regulator
- On-going research and interviews: a work in progress
  - How do regulators and regulatory regimes in different parts of the globe fit into the Cultural Theory framework?
  - Effect of changes in regulation (S2, ICP, etc.)
- Reminder of this presentation will set out initial thoughts from our research to date and interviews with senior regulators.



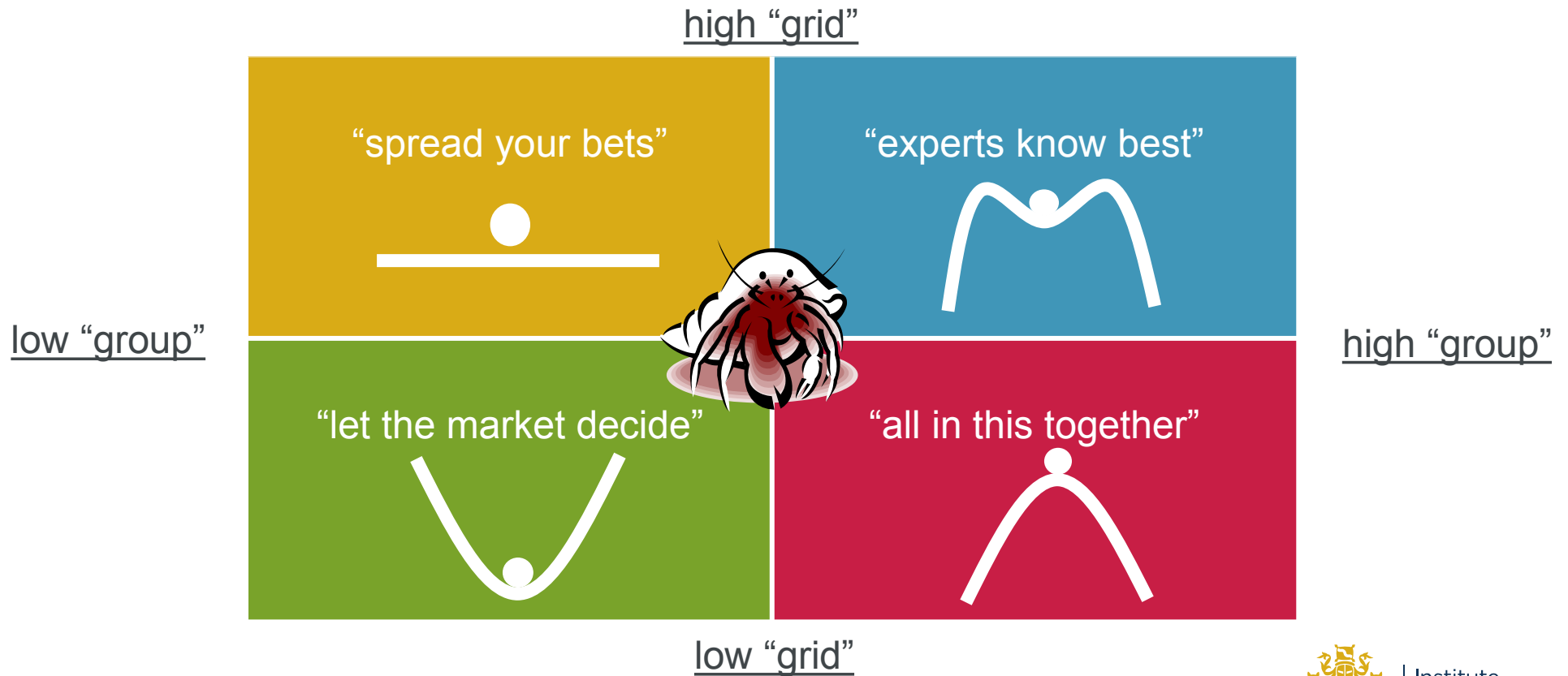
# A-priori views of regulatory rationality

## We considered what a regulator is?

- The word ‘regulator’ describes a ‘control mechanism’ which limits the range of a variable to within a set range.
- In the insurance industry, the variables are related to insurance products, e.g.
  - Probability of claims payment when due
  - Information provided at point of sale
- Insurance regulator must
  - Understand the human social environment
  - Change the behaviours of the humans in the system in order to keep the ‘outputs’ within the desired range.
- A priori view was that regulators are probably ‘managers’.



# Mapping the regulators



# Interview Impressions

- Regulators are surprisingly ‘hermit’-like.
- Regulators and the social context
  - Regulatory capture is possible when regulators sing to the ‘mood music’ of the moment.
    - Social environment of the regulators
    - Regulators of the regulators
  - Regulatory ‘red lines’ – e.g. Glass-Steagal Act – help to mitigate.
- Examples of Tendencies
  - Maximiser: Draw red lines – then leave to the market.
  - Manager: Use power to ring fence assets and protect local policyholders
  - Conservator: Stop the poor being taken advantage of.





# Regulating Through The Cycle

Surprise matrix

Economic Cycle Stages



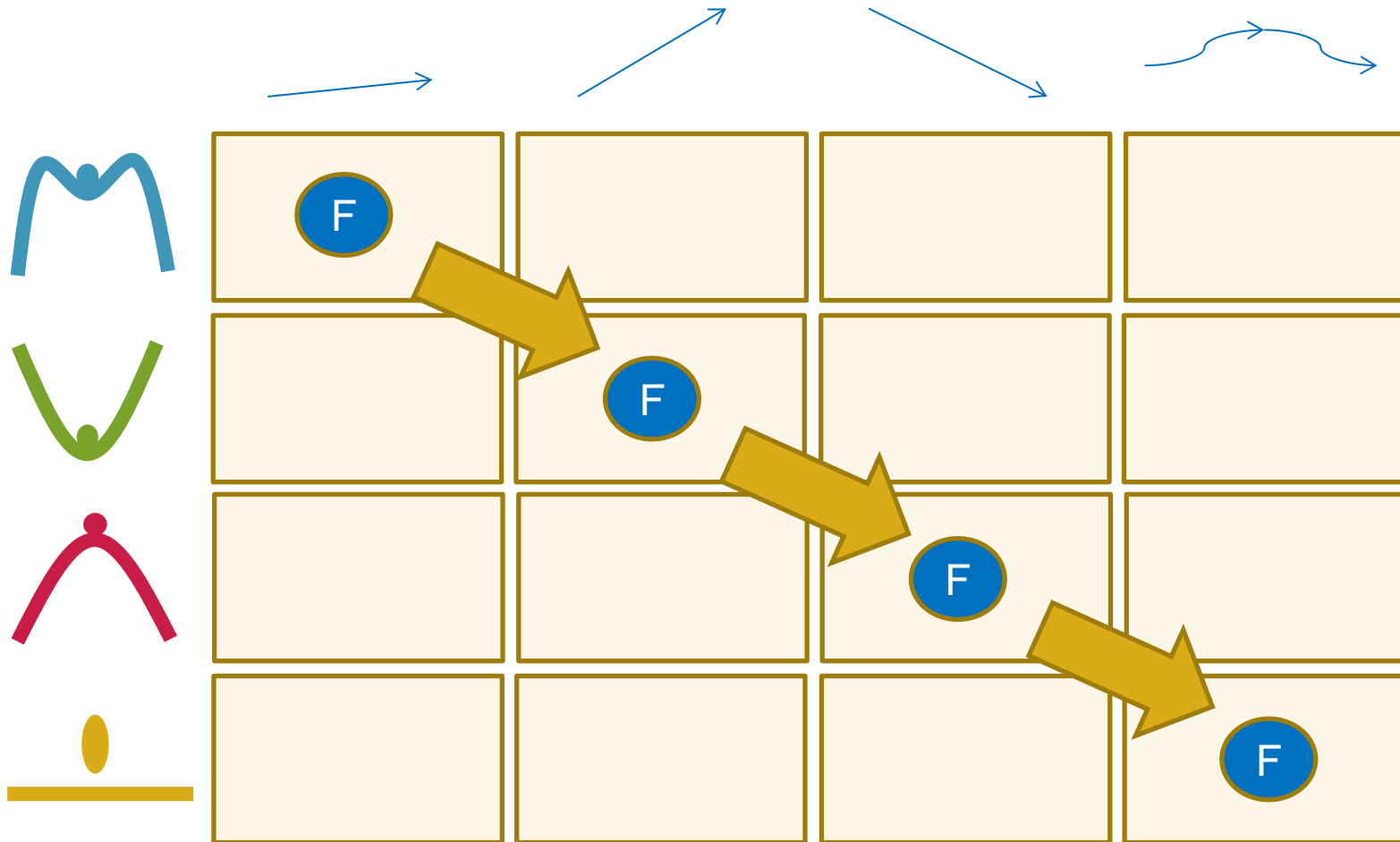

The Plural Rationalities



Institute and Faculty of Actuaries

# Firms Through The Cycle

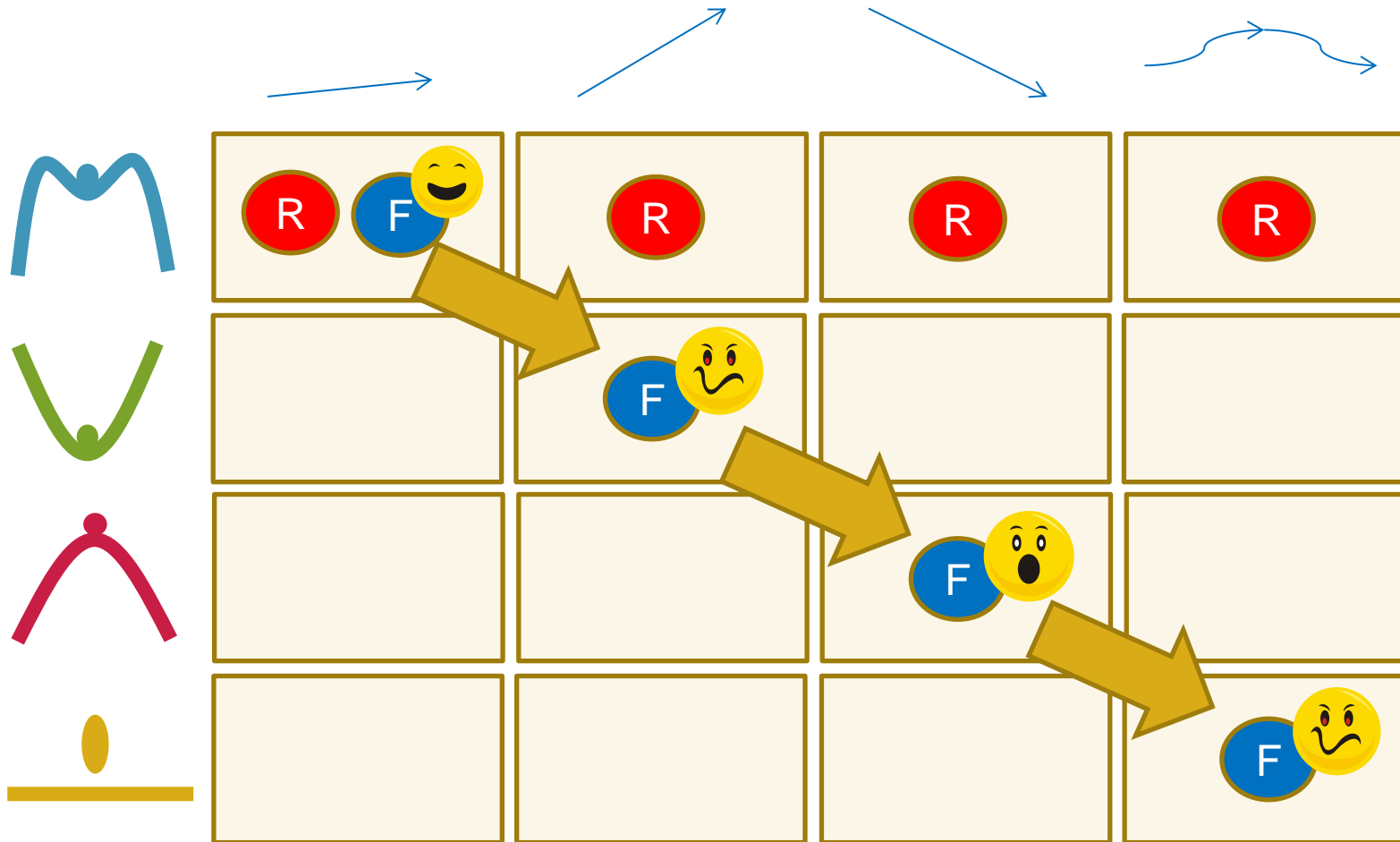
Agent based models suggest firms trace diagonal



Institute  
and Faculty  
of Actuaries

# Regulating Through The Cycle

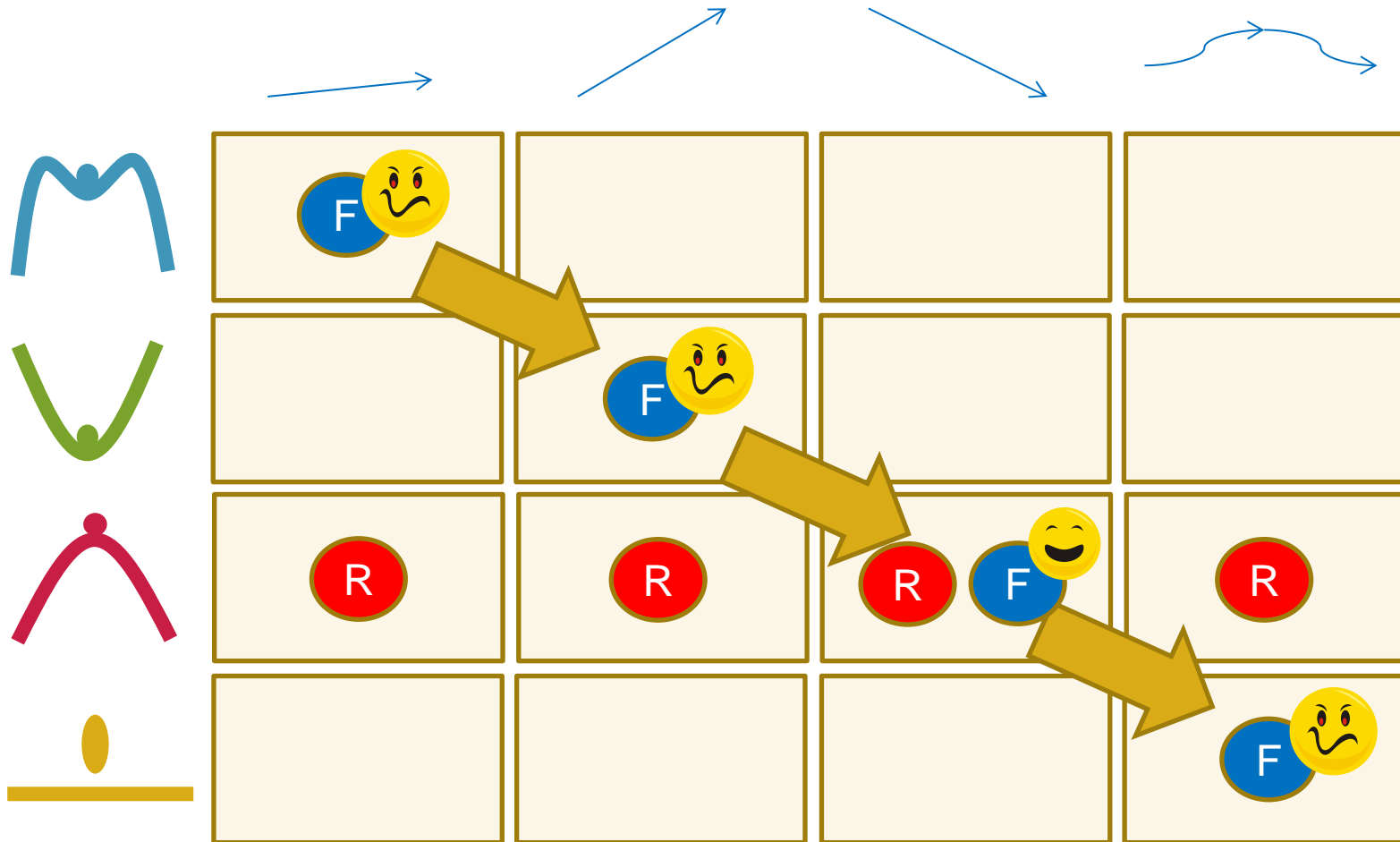
Firms and the hierarchical regulator



Institute  
and Faculty  
of Actuaries

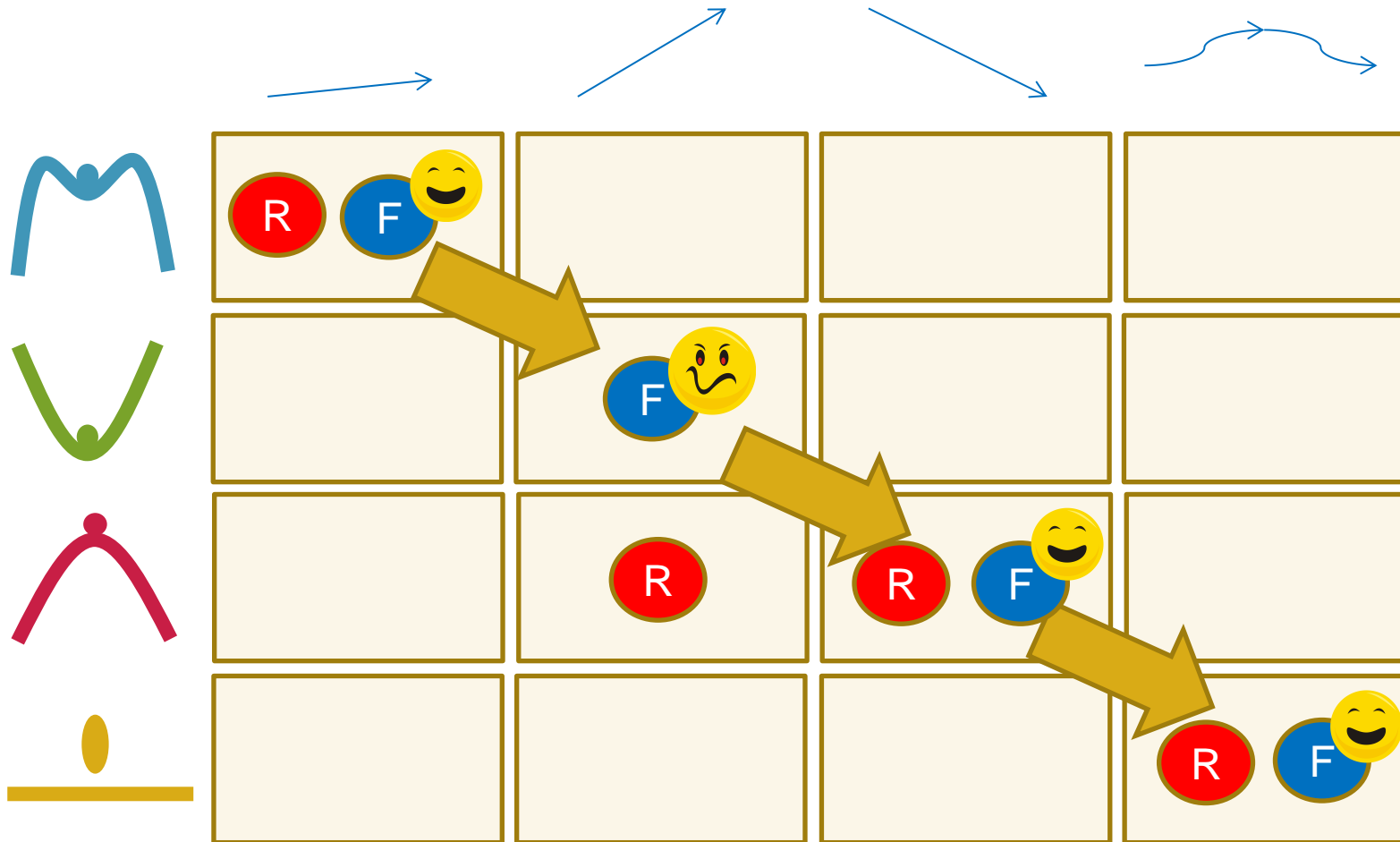
# Regulating Through The Cycle

Firms and the egalitarian regulator



# Regulating Through The Cycle

Firms and the adaptable hermit regulator



# Regulatory Careers

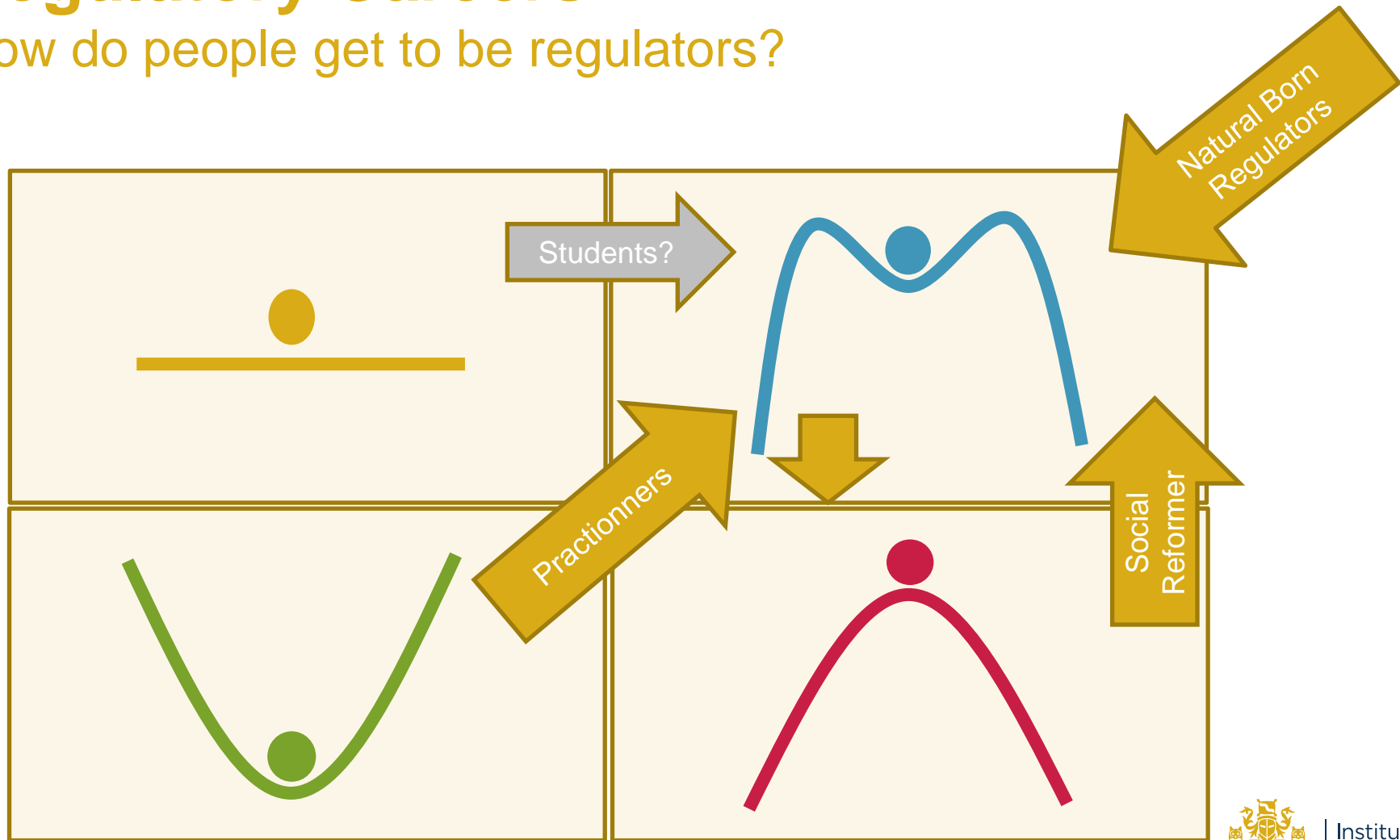
## Why become a regulator?

- Simple a priori notions
  - Power to influence the industry (Manager)
  - Correct perceived injustices within the industry (Conservator)
- More complex: few had these aims
  - Didn't expect to stay long, BUT got hooked on the job and never left.
  - Who knew regulators were like Hotel California?
- Changing motivations
  - From Maximizer to Manager to Conservator?



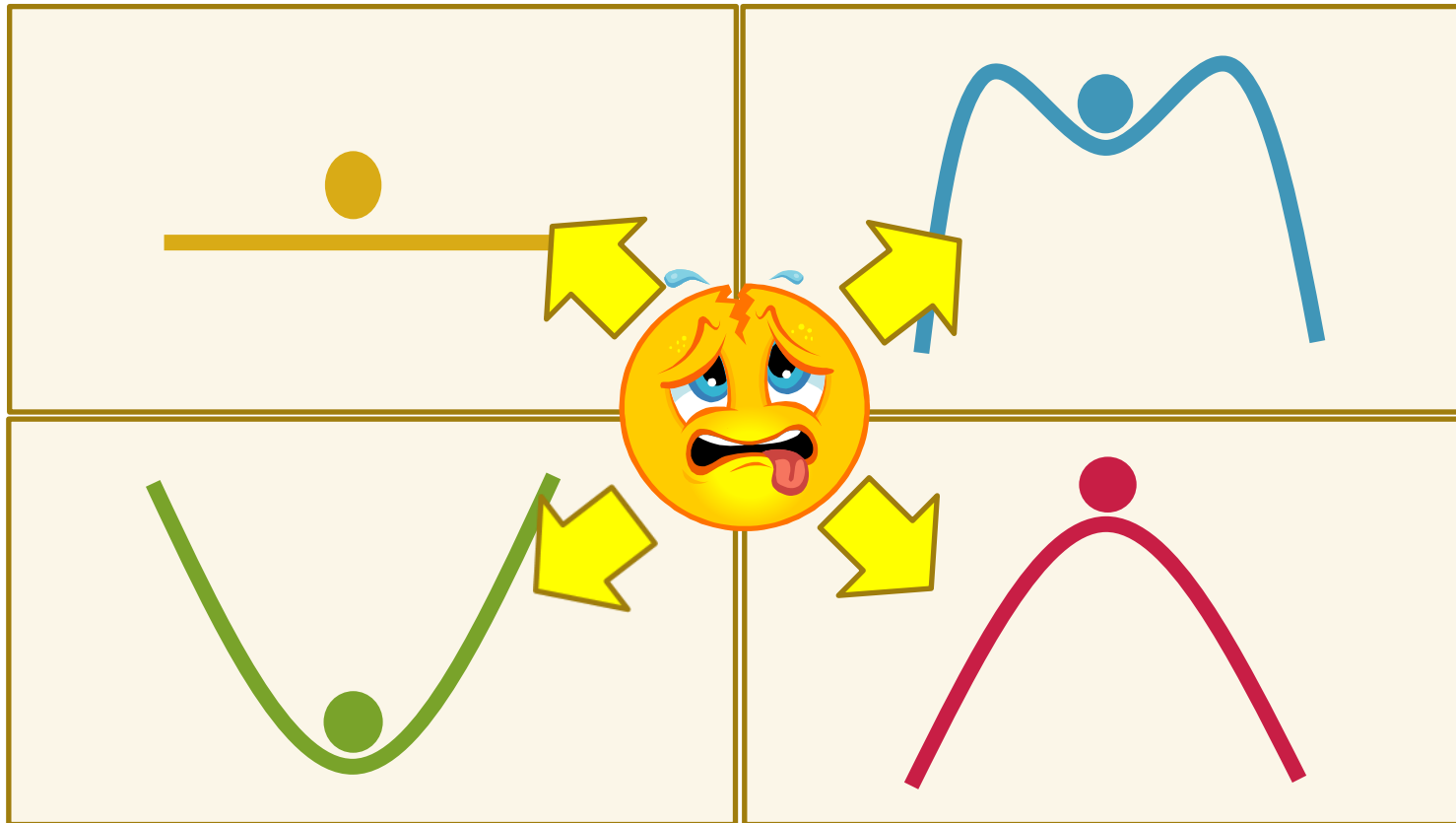
# Regulatory Careers

How do people get to be regulators?



# Split Personalities

Can you be multiple rationalities and still be rational?





# Conclusions



# Questions

# Comments

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

The views expressed in this presentation are those of the presenter.



Institute  
and Faculty  
of Actuaries