GIRO conference and exhibition 2010
James Illingworth

Risk Management
Relying on Others – the CRO Perspective

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- Role of Senior Management and Boards
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- Roles and functions internal and external
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

RISK — Strategic Approach to the Business Model — REWARD

- Cat risk
- Reserving risk

Insurance Risk
- Diversification and Pricing

Profit from Risk Transfer

Market Risk
- Asset Value Volatility

Payment for Asset Risk

Operational
- Managed and measured

Credit
- Managed and measured

Liquidity
- Managed and measured

Capital
- Modelling & Management
Guardianship of the Business

What goes wrong:

- Underwriting risk: Unbalanced and/or misunderstood
- Market risk: Correlations, systemic problems unmanaged
- Operational: Not adequately managed
- Liquidity: Stressed by extreme circumstances
- Credit: Stressed by extreme circumstances

Capital: Inadequate or inaccessible
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

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Roles in Managing Risk – internal structure

FINANCE

UNDERWRITING

RISK & ACTUARIAL

OPERATIONS & IT

INVESTMENT MANAGEMENT
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