Better Decision Making ERM

- Context
- Principles & High-level Approach
- The Business Plan
- Decision Making
- BDM ERM in Practice
- Summary
Better Decision Making ERM

• **Context**
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Better Decision Making ERM Context

- What is ERM?
- Is ERM real?
- Can actuaries add value to ERM?
Better Decision Making ERM

Context

- What is ERM?
### Table 1
ERM definitions and descriptions from academic journals

<table>
<thead>
<tr>
<th>Source</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dickinson (2001)</td>
<td>ERM is a systematic and integrated approach of the management of the total risks a company faces.</td>
</tr>
<tr>
<td>D'Arcy and Brogan (2001)</td>
<td>ERM is the process by which organizations in all industries assess, control, exploit, finance and monitor risks from all sources for the purpose of increasing the organization's short and long term value to its stakeholders.</td>
</tr>
<tr>
<td>Casualty Actuarial Society</td>
<td></td>
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<tr>
<td>Harrington et al., 2002</td>
<td>ERM is the idea that emerged in the late 1990s that a firm should identify and (when possible) measure all of its risk exposures — including operational and competitive risks — and manage them within a single unified framework in contrast to the silo approach to risk management.</td>
</tr>
<tr>
<td>Meulbroek (2002a)</td>
<td>Integrated risk management is the identification and assessment of the collective risks that affect firm value, and the implementation of a firm-wide strategy to manage those risks.</td>
</tr>
<tr>
<td>Barton et al., 2002</td>
<td>Enterprise-wide risk management shifts risk management from a fragmented, ad hoc, narrow approach to an integrated, continuous, and broadly focused approach.</td>
</tr>
<tr>
<td>Verbrugge et al. (2003)</td>
<td>ERM is corporate-wide, as opposed to departmentalized, efforts to manage all the firm's risks — in fact, its total liability structure — in a way that helps management to carry out its goal of maximizing the value of the firm's assets. It amounts to a highly coordinated attempt to use the right-hand side of the balance sheet to support the left-hand side — which, as finance theory tells us, is where most of the value is created.</td>
</tr>
<tr>
<td>Liebenberg and Hoyt (2003)</td>
<td>Unlike the traditional “silico-based” approach to corporate risk management, ERM enables firms to benefit from an integrated approach to managing risk that shifts the focus of the risk management function from primarily defensive to increasingly offensive and strategic. ERM enables firms to manage a wide array of risks in an integrated, holistic fashion.</td>
</tr>
<tr>
<td>Kleffner et al., 2003</td>
<td>In contrast to the traditional “silico-based” approach to managing risk, the ERM approach requires a company-wide approach to be taken in identifying, assessing, and managing risk.</td>
</tr>
<tr>
<td>Sobel and Reding (2004)</td>
<td>ERM is a structured and disciplined approach to help management understand and manage uncertainties and encompasses all business risks using an integrated and holistic approach.</td>
</tr>
</tbody>
</table>
Better Decision Making

<table>
<thead>
<tr>
<th>ERM definitions and descriptions from standards setting organizations, industry publications, industry associations, consulting firms, and rating agencies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(AS/NZS 4360 Risk Management Standard, 1995)</strong></td>
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<tr>
<td><strong>Holton (1996)</strong></td>
</tr>
<tr>
<td><strong>Banham (1999)</strong></td>
</tr>
<tr>
<td><strong>Arthur Andersen (Described in Deloach and Temple (2000))</strong></td>
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<tr>
<td><strong>Miccolis (2000)</strong></td>
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<tr>
<td><strong>Garzon (2000)</strong></td>
</tr>
<tr>
<td><strong>Tillinghast-Towers Perrin (2001)</strong></td>
</tr>
<tr>
<td><strong>Institute of Internal Auditors (IIA, 2001)</strong></td>
</tr>
<tr>
<td><strong>Casualty Actuarial Society (CAS, 2003a)</strong></td>
</tr>
<tr>
<td><strong>Committee of Sponsoring Organizations (COSO) (2004)</strong></td>
</tr>
<tr>
<td><strong>S&amp;P (2008)</strong></td>
</tr>
<tr>
<td><strong>ISO 31000 (2010)</strong></td>
</tr>
<tr>
<td><strong>Risk and Insurance Management Society (RIMS) (2011)</strong></td>
</tr>
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</table>
Better Decision Making ERM

Context

What is ERM?

- No single accepted definition
- Emerging consensus
  - Managing firm more important than components
  - Not only traditional risks, includes strategic risks and competitor actions
  - Not just a problem, also an opportunity
- No (academic) link found to value
- Huge range of subjects for research
- Businesses like it like that?
Better Decision Making ERM

Context

Is ERM a value-adding activity?
- Is it meant to be?
- Will it mean more resource?
- Will we have to be different from the industry?
- Is the CRO seen as a value driver or a compliance manager?
- Will moving away from the current process threaten regulatory compliance?
Better Decision Making ERM

Context

“…virtually all literature is silent on how to deal with the myriad cultural, logistical, historical challenges that exist and are unique to all organizations… Many of the articles describe what the process should look like and how it should function, but there are few that provide details of how to get to that step. Many of the articles use great overarching statements that seem very much like motherhood statements. There was a distinct lack of information on how to bring all the silos together… The impact of corporate culture on ERM implementation and practices is not well addressed in the literature.”

- Attributed to Fraser et al in the Bromily paper
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Can actuaries add value to ERM?
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Better Decision Making ERM Principles & High-level Approach

BDM ERM

An ERM reporting approach that considers the business plan, how decisions affect the business plan and how the results deviate from those expected, and thus, how to improve the quality of decision making.
Better Decision Making ERM Principles & High-level Approach

BDM ERM

- part of ERM reporting
- an addition to the ERM toolkit
- may rely on other parts of the ERM programme
Better Decision Making ERM
Principles & High-level Approach

Overarching Principle

Risk is added or subtracted from a business as a result of decisions made.
If risk depends on the decisions made, then how those decisions are made is of intense interest.
Better Decision Making ERM Principles & High-level Approach

Communication

The best expression of the expected outcomes from decision making is the business plan.
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The Business Plan

• BDM ERM business plan may be different from existing plans

• Separate
  – business-as-usual plan and
  – impact of developments

• Range more useful than point estimates

• Automatically addresses materiality

• Provides a route to consider new developments
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Decision Making
Commission Delegated Regulation (EU) 2015/35

Article 259
Risk Management System

1. Insurance and reinsurance undertakings shall establish, implement and maintain a risk management system which includes the following:
   (a) a clearly defined risk management strategy which is consistent with the undertaking’s overall business strategy. The objectives and key principles of the strategy, the approved risk tolerance limits and the assignment of responsibilities across all the activities of the undertaking shall be documented;
   (b) a clearly defined procedure on the decision-making process;
Better Decision Making ERM
Decision Making

How to make Better Decisions

- Seriously consider at least two robust options per decision
- Challenge robustly to avoid heuristics/natural biases
- Find some distance
- Set robust review points and mean them
Better Decision Making ERM
Decision Making

How to make Better Decisions

- Seriously consider at least two robust options per decision
  - Seldom just one choice
  - Consider concurrent options
  - Imagine if your favourite option disappeared

- Challenge robustly to avoid heuristics/natural biases
  - How do you counter confirmation bias?
  - Devil’s advocate. Six Thinking Hats
  - What would be the conditions for this to be the best option?

- Find some distance
- Set robust review points and mean them
Better Decision Making ERM
Decision Making

How to make Better Decisions

- Seriously consider at least two robust options per decision
- Challenge robustly to avoid heuristics/natural biases
- Find some distance
  - Zoom in, zoom out
  - What would my successor do?
  - Pilot to test assumptions
- Set robust review points and mean them
  - Check outcomes against the plan
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Better Decision Making ERM
In Practice

How does BDM ERM add to effectiveness?

How does it work?

Board agrees a plan

- with results shown as corridors
- with risk mitigation expressed via the impact on outcome corridor
- with shock risk shown explicitly and separately

Board agrees the decision-making process
Better Decision Making ERM  
In Practice

How does BDM ERM add to effectiveness?

How does it work?

Board reviews results

- of business as usual
- of developments in progress or just implemented

using, inter alia, the output from the decision-making process and

- a formal comparison of actual with expected
Better Decision Making ERM
In Practice

How does BDM ERM add to effectiveness?

What does it achieve?

Single space for high quality Board challenge
No silos
Appropriate materiality
Natural risk appetite
Better Decision Making ERM
In Practice

How does BDM ERM add to effectiveness?

The Role of the Chief Risk Officer?

Continually able to say…

…whether we are going to meet the plan?

…why we are deviating from plan?

Counterpart to the CFO
Better Decision Making ERM
In Practice

How does BDM ERM add to effectiveness?

For actuaries?

Natural risk enumerators

Projections relatively simple

Assumption setting

Actual versus Expected is natural territory
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Summary

• Risk is added or subtracted through decisions made
• The business plan is the summary of expected outcomes
• The BDM ERM business plan may split activity by risk characteristics
• Follow up is crucial
• Decision-making process is important
• There are techniques to proofing decisions
• The CRO has a proper role in this process
• Actuaries are well suited to supporting BDM ERM
Better Decision Making ERM

The End