Implementing ERM

Practical experiences and learnings

3rd Seminar on Enterprise Risk Management

A presentation by BN Rangarajan and Kunj Behari Maheshwari

10 October 2014

Agenda

- Implementing ERM: Why insurance companies bother
- Recounting experiences:
  - Where to start and what to do – setting out a roadmap
  - The biggest challenge: Achieving buy-in
  - Building the tools: setting up a risk register
  - Determination and application of risk limits
- What success looks like: anecdotal examples
  - What's really changed in BAU?
- Questions and discussion

"The Banks Invented ERM and They Blew Up, So Why Should We Bother?"

The stick

- Regulatory scrutiny – specific instructions from the regulator following inspection
- Compliance – Solvency II / Sarbanes–Oxley
- Sales / Acquisition – resulted in changes in operational dynamics and created potential gaps
- Pressure from rating agencies
- Large operational losses led to pressure from the Board to revisit risk management
- Senior executive departure (CEO / CRO) acted as a catalyst for change

The push for developing more robust ERM frameworks have come largely from the regulator or other external factors…

…But many insurers have taken the opportunity to then enhance scope and seen business benefits materialise

The carrot

- Natural evolution of a growing business
  - i.e. stronger risk management foundations needed in order to support growth strategy
  - Greater management control and over-sight
- Enhances valuations
  - "Good for the brand" : fits in well with the business vision to have **best-in-class functions**
  - Helps in **confidence building** with the investors
- Expected business benefits
  - More "risk informed" strategic and operational decisions
  - Improved risk adjusted returns and more efficient use of capital
  - Faster reaction to risk events, resulting in greater control over the outcome and reduce potential losses

Key drivers:

Reasons cited by some companies for undertaking large scale implementation projects to enhance their ERM framework

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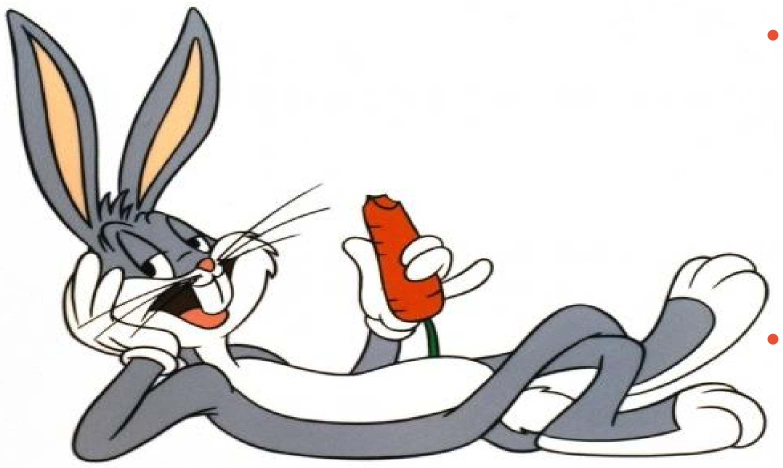

In India, no real external pressure currently to adopt ERM…

…so, any initiatives to the effect are mainly driven by perceived benefits, addressing specific business needs

Only carrots, and no sticks!

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Key drivers:

Learnings that insurers in India can borrow from their global counterparts in beginning to setup ERM frameworks early

- Many ERM implementations have largely been about setting up appropriate policies, procedures and controls within the organisation with clearly defined accountability for all decisions and actions
- These feed into the overall management information and reporting => enabling more effective grass-root over-sight by top management whilst ensuring devolution of day-to-day operations within the "policy limits"
- **Could many of the issues regarding mis-selling have been avoided with such controls in place?**

- Demonstration of strong ERM credentials are beginning to play a very critical role in confidence building with investors: all the top European insurers (by market capitalisation) are putting increasing emphasis on ERM related matters in their Annual Reports and investor communications with quantitative & qualitative complementary disclosures on risk management
- Strong tool for talent retention: people love to work for the best-in-class
- **Could this be the X-factor in insurance company valuations when it comes to IPOs and valuations for M&As?**

- Some insurers have focussed on not just the adverse risk events whilst setting up risk policies and processes but also positive risks that they would like to seek and exploit => critical that this is carried out in a "controlled manner"
- Zero tolerance for non-rewarding risks (e.g. operational risk)
- **Could we identify risks that we would like to seek without breaching the risk appetites, for example use robust analysis to set dynamic investment mandates that could maximise returns without being *too risky*?**

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Where to start and what to do – setting out a roadmap

Narrative from a Company that started its ERM implementation in January 2014, and is currently in progress

- As the first step, the end-state or target operating model for the ERM framework was established
- This exercise alone took more than a few months – output: just one slide !
- The single page framework guides all necessary actions for the remainder of the project and informs the overall objectives from the Company's ERM work
- This has now been drafted as **mandatory training for all company employees** and included as part of the Company's induction programme

Key lessons learnt

- ✓ Executive sponsorship and understanding of the objectives from start
- ✓ Clarity of goals and mile-stones with prioritised "must-do's"
- ✓ Appropriate representation from all functions
- ✓ Demystifying / removing jargon
- ✓ Clear line-of-sight !

Where to start and what to do – setting out a roadmap

Narrative from a Company that started its ERM implementation in January 2014, and is currently in progress

- Plan outputs and tasks, predominantly driven by the target operating model.
- Table below sets out key implementation tasks, ordered by relative priority and broad work-streams:

	Fit-for-purpose		Good practice		Best-in-class
Vision design & direction	- ERM Framework	- Assurance plans - Reporting Calendar	- Documentation tree		- R&C Charter
Governance		- Activity matrix - 3LOD definitions	- Committees - R&C role profiles - TORs	- Minimum mgmt. standards	- Corporate Governance Policy & manual
Risk appetite and strategy	- Aligned risk appetite and business strategy - Risk capital metrics	- Risk appetite metric reporting	- Reputational, value, liquidity risk metrics		
Risk processes	- R&C procedures	- Reviewed risk universe	- Enhanced operational risk modelling	- Policy framework - Assessed suite of risk policies	- Emerging risks (methodologies & processes) - Loss & incident process
Risk reporting		- MI reporting	- Horizon scanning - Key risks - Emerging risks	- Additional MI reporting	- MI tools and dash-boards
Training	- Executive trainings	- Risk culture survey - Training needs analysis	- R&C function training - ERM in detail training - Risk based decision making training	- Refine recruitment and induction processes	- MI tools and dash-boards

Jan 2014 → Mar 2015

The biggest challenge: Achieving buy-in

- The biggest challenge most often cited is the lack of wider engagement and buy-in: **Getting out of the models and into the business**

- Even where executive sponsorship and buy-in is available, there is significant resistance within the functional departments to protect status quo, thus preventing ERM from *bedding-in*

- Key lesson learnt from embedding work-streams - We need to convince the business of two things:
  - First, that ERM is relevant to each and every department and individual within the organisation and effectively affects the way we manage our business
  - Second, we need to understand ourselves that most of the components of ERM and what is needed probably already exist in the organisation. The implementation of an ERM framework is predominantly to formalise these best practices and ensure they get reported up to the relevant levels of the management

- Some successful strategies adopted to embed ERM and obtain buy-in :
  - Active business-wide trainings – separate modules designed as relevant to the individual and his role in the organisation
  - Wide communication of significant operational and strategic decision making and consideration of risk in each decision
  - Less perfecting the process in design stage – embedding and refining over time
  - Prioritise MI early in the process for all departments
  - Assign specific role and accountabilities with respect to risk and compliance to each individual and ensure these are understood

Building the tools: setting up a risk register

- Steps required to complete a risk register
- What is the appropriate level of delegation and who decides on the contents for each item in the register ?
- Sources of information
- How many risks to be included? What should be the granularity?
  - Appropriate classifications (risk categories and sub-risks)
- Appropriate criteria for deciding whether a particular risk should be “in” or “out”.
  - Examples of borderline risks.
  - How to deal with emerging risks
- Criteria for qualitative or quantitative risk scores
- Who owns and who uses the risk register?
- Examples of use of risk registers in practice

Determination and application of risk limits

- Choosing the appropriate metric / risk indicator
- The process of limit setup: A walk-through
- Asset value conundrum: Book Values or Market Values ?
  - What about equities?
- Frequency of calculations? How onerous for BAU teams?
- Monitoring and reporting – how well understood are the limits?
- Applications

What’s really changed in BAU?

- Clearer Accountabilities
- Better understanding of the risk profile v appetite
- Improved awareness of ERM in the business
- Improved Risk & Compliance processes
- Stronger risk governance
- Better risk oversight of projects and OSPs

What success looks like: anecdotal examples

A successful ERM implementation will result in **Clear Objectives, Governance and Organisational Structure** wherein the business as usual activities inherently incorporate the required activities whereby opportunities are readily identified and exploited and for adverse risks, Plan B (and C…) are prepared.

Key deliverables from a successfully completed ERM implementation project:

People, training and competence
- Fit and proper
- Approved persons
- Performance management
- Online training / CBT
- R&C team skill-base
- Team structures & resourcing
- Companywide R&C communications
- Board/Exec training
- Awareness of new regulations
- Prudent person principle

Tools and Systems
- Risk register
- R&C Outputs register
- Loss, incidents and breaches database
- Computer based training systems
- Risk universe
- Annual assurance plan
- Risk & compliance Calendar
- Reporting calendar
- Materiality framework
- Process templates

Methods & processes – (Risk)
- Control and risk self assessment
- Assurance
- Loss and Incidents
- Project Oversight
- Scenario testing
- Emerging risks
- Management actions
- ORSA
- OSP Oversight
- Reverse stress testing

Methods and Processes – (Compliance)
- Policy attestation
- Assurance
- Breach handling
- Project Oversight
- Financial promotions
- Horizon scanning
- Approved persons
- Literature oversight
- OSP Oversight
- Permissions and waivers

Documentation
- Risk policies and sub-policies
- ERM Framework
- Governance manual
- Functional TOR
- Process frameworks
- Risk & Compliance charter
- Risk appetite and strategy
- Governance structures
- Line 1 procedures
- Line 2 procedures

What success looks like: anecdotal examples

Example of MI dash-boards: New Business

Readily available tools and reporting templates provide live information to management on emerging business activities as well as enable them to “play” with likely model outcomes of strategic decisions.

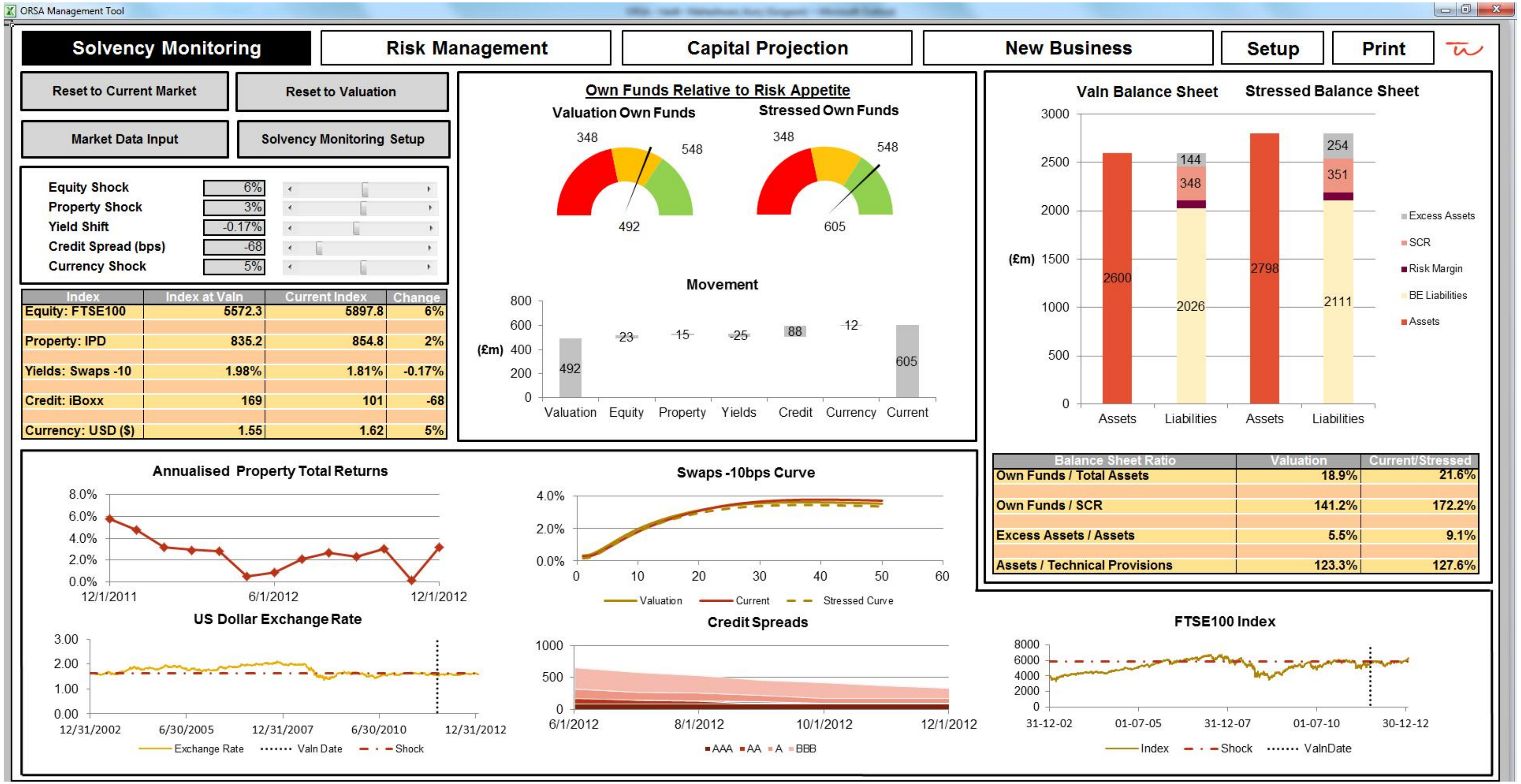
In this example, new business volumes can be adjusted to provide results and analysis in real time.

What success looks like: anecdotal examples

Example of MI dash-boards: Solvency Monitoring

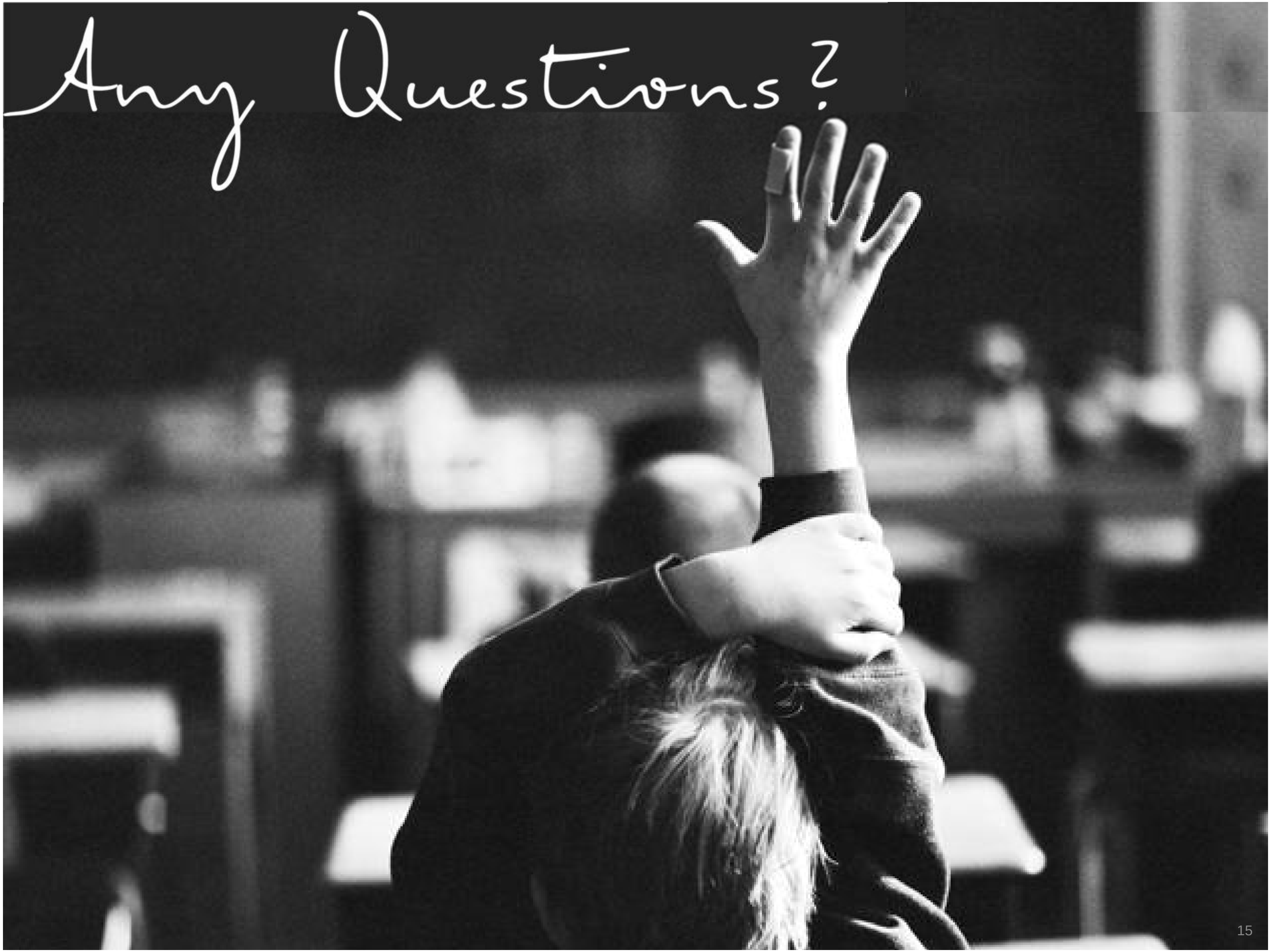
Readily available tools and reporting templates provide live information to management on emerging business activities as well as enable them to “play” with likely model outcomes of strategic decisions.

In this example, market indices affecting solvency can be adjusted to provide results and analysis in real time.



Index	Index at Valn	Current Index	Change
Equity: FTSE100	5572.3	5897.8	6%
Property: IPD	835.2	854.8	2%
Yields: Swaps -10	1.98%	1.81%	-0.17%
Credit: iBoxx	169	101	-68
Currency: USD ($)	1.55	1.62	5%

Balance Sheet Ratio	Valuation	Current/Stressed
Own Funds / Total Assets	18.9%	21.6%
Own Funds / SCR	141.2%	172.2%
Excess Assets / Assets	5.5%	9.1%
Assets / Technical Provisions	123.3%	127.6%


Any Questions?