Responding To Risk

Enterprise Risk Management Seminar

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Actuaries Institute • Sydney

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Responding to risk

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Appropriately responding to risk improves resilience

Goldman Sachs

Global financial crisis

Risk management teams work collaboratively with business management

Robust risk assessment of strategy

Berkshire Hathaway

Global financial crisis

Well defined & adhered to risk appetite that provides boundaries to investment decisions

Robust scenario (loss) analyses

Wells Fargo

Inappropriate sales practices resulting in $185m fine

Inadequate risk framework in design of employee sales incentive program. Lack of risk aware culture

Lack of business ownership of risk leads to inappropriate incentives and poor or no risk monitoring activities

Resilience to risk is embedded in the business through designing and implementing a fit for purpose risk management framework

Governance

Board & Board Risk Committee; Management Risk Committees
Enterprise Risk Management Function
Mandates / Risk Policy / Procedures

Strategy & Appetite

Risk Strategy – describes how material risks are managed
Risk Appetite Statement – describes the amount and nature of risk acceptable in the pursuit of the corporate strategy

Identify & measure

Risk Identification

- Risk modeling, sensitivity and stress / event scenarios for "quantitative" risks
- For "qualitative" risks:
  - RCSA / scenario analysis / KRIs / Incident logging
  - Emerging Risk Process

Risk Measurement & Analysis

- Exposure/Risk
  - Capital at Risk
  - Earnings at Risk
  - Liquidity at Risk
  - Reputation at Risk
- Stress and scenario analysis

Monitor & Optimise

Monitor & Report

- Aggregate across group
- Business / product lines
- Legal Entities
- Report on: Exposure/Risk /Limits; point in time / trend / forward looking

Optimise & Mitigate

- Actions to keep or bring risk within risk appetite
  - Reinsurance
  - Reduce exposure
  - Hedge
  - Recovery / resolution planning

Systems & Data

People & Culture

Risk Taxonomy

Market | Credit | Liquidity | Insurance | Operational | Concentration | Strategic

Risk should be considered throughout the strategic planning process to increase business resilience

ERM provides framework, oversight & challenge

Strategy & Budgeting Process

1 - Board assumptions & themes

ERM input
- Identify emerging risks
- Assess future state of regulations

2 - Strategic narrative & project initiatives
- Gain leadership buy-in through risk analysis (perceived vs actual cost)
- Review upcoming compliance obligations
- Assess capacity and capability to execute strategy
- Identify risks requiring remediation

3 - Business assumptions & budgets
- Challenge assumptions
- Test models for accuracy in forecasting

4 - Threats to achieving strategy
- Assess changes in environment (customer, competitor, regulatory, economic)
- Advise on implementation challenges
- Provide a resilience lens to future states

5 - Scenarios & stress testing
- Create scenarios for assessment
- Calculate impacts
- Feed back into assumptions & budgets (add contingency)

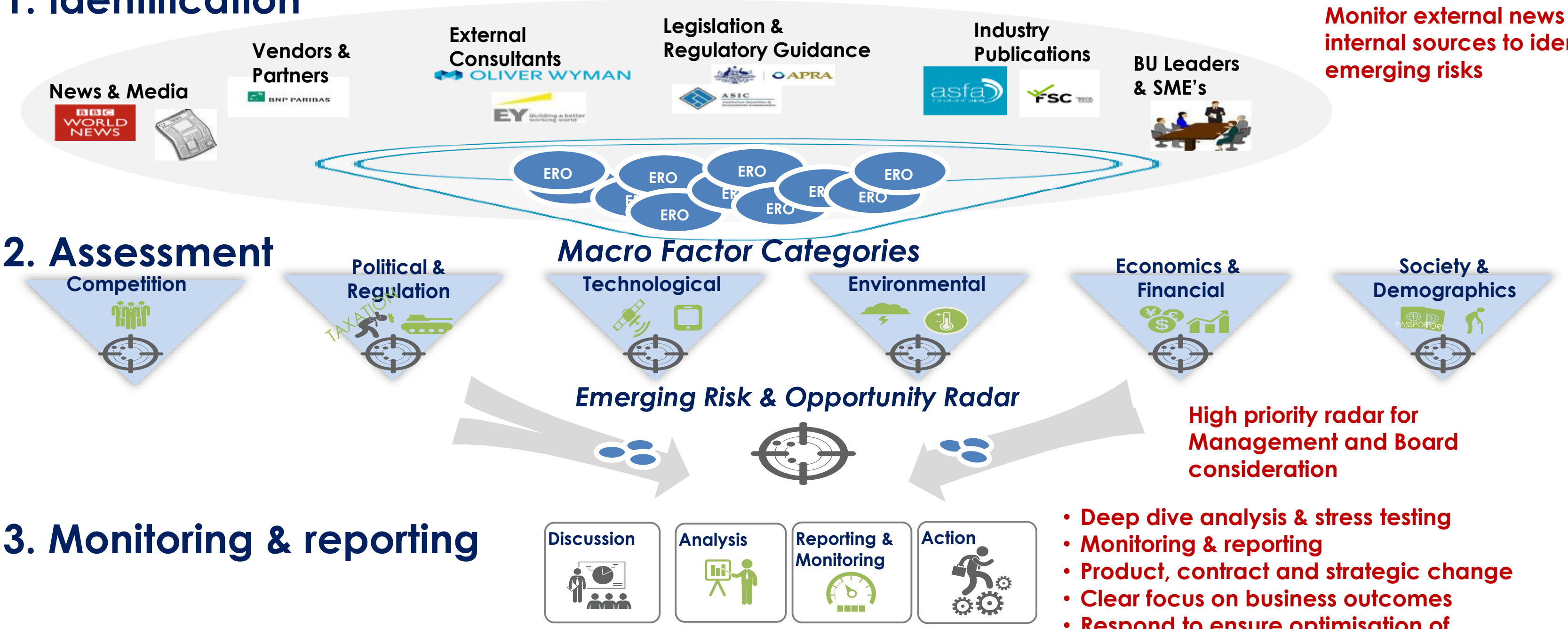
6 - Strategic risk appetite
- Calculate impact of strategy on appetite
- Translate and apply appetite to decisions

Insight into emerging risks is an important component of increasing business resilience

1. Identification

2. Assessment

3. Monitoring & reporting



Monitor external news and internal sources to identify emerging risks

High priority radar for Management and Board consideration

- Deep dive analysis & stress testing
- Monitoring & reporting
- Product, contract and strategic change
- Clear focus on business outcomes
- Respond to ensure optimisation of return/risk

Analysis of emerging risks should be driven to produce business insights and potential management actions

Dimension	At a fundamental level, four dimensions are used to measure and limit the impact of risk
Capital adequacy	• Reflects the firm's level of protection/buffer against significant losses that could lead to default or emergency balance sheet restitution • Can be both regulatory (e.g. LAGIC / Basel / Conglomerates ratios) or economic (e.g. Economic Capital) views of balance sheet strength
Earnings stability	• Constrains excessive volatility of profits or losses arising from specific portfolios, business lines products or activities • Provides protection against "nasty surprises" and serves to deliver appropriately predictable returns to shareholders
Liquidity	• Reflects the firm's level of protection against a period of prolonged funding stress that could lead to illiquidity and eventually to insolvency • Constrains the funding mix, keeping cost of funds at risk-optimal levels • Ensures the firm can meet its cash obligations without having to resort to an asset fire sale
Reputation	• Articulates the appetite for risks that are difficult to measure but can be a substantial threat to a firm's overall reputation and hence long-term value • Includes customer value perception, employee satisfaction, regulatory compliance, etc.

Fit for purpose risk management should be included in all strategic and day-to-day business decisions to improve resilience

Stage	Process	Impact
Ex-ante	Business and resource planning	ERM provides risk bounds within which business and resource should be planned
	Limit setting	Limits are aligned to the quantified RAS to give entities room to optimise risk and return while staying within appetite
	Capital management	Risk appetite, strategic planning and capital management processes are closely integrated within the business planning process
	Stress testing	Provides a pass/fail reference for stress testing results by including performance under stress metrics
	New product approval	ERM provides guidance on in-/out-scope product risks and acceptable accumulated risk profiles (board-set appetite empowers the CRO to enforce discipline on new product creation)
Day-to-day	Portfolio risk assessment	Provide a reference for acceptable risks in the portfolio
	Systems and controls	RAS should be incorporated in automated limit systems and control processes in such a way as to signal potential breaches
	Pricing	Different pricing levels and structures can imply different risk profiles, both from a direct financial perspective and in terms of resulting portfolio mix and level
	ALM	Appetite set for ALM risks sets limits on ability of ALCO to optimise risk and return with proprietary risk taking
Ex-post	Risk and capital reporting	Risk position should be reported in reference to the risk appetite statement under different scenarios, especially on the more senior levels
	Performance management	Adherence to risk limits should be a minimum requirement for all executives where controlled