



Institute of Actuaries of Australia

# 2004 Financial Services Forum ...The New Environment

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# Risk Measurement/ Risk Management

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# Synopsis

There is an increasing focus in the financial services industry on the management of risk which together with heightened risk awareness has increased appetites for more risk information. This is leading to renewed efforts for meaningful reporting of risk and is driving more and better risk measurement.

The aims of this session are for participants to exchange views on the prevailing trends in risk measurement and management in the financial services industry, and likely or desirable future directions.

The session will open with a brief presentation including a review of industry practice and trends, though not a detailed discussion of techniques. The majority of the session will consist of discussion and debate around key topics of risk measurement and management.

# Introduction

- Risk Management and Measurement
- Context of risk bearing institution
- Insurance/bank/health/funds managers/non bank lenders
- Not a detailed technical discussion  
e.g. no algebra

# Content

- Brief History of Risk Measurement & Management in FS industry
- The Present
  - Where is industry currently
  - Challenges and trends
  - Reasons for change
- The Future?
- Discussion topics

# Brief History

- History of Risk Measurement
  - What is risk?
  - What has risk been?
- Banks
  - Balance sheet focus (esp. credit risk)
- Life Insurers
  - Heavy involvement of actuary
- General Insurers
  - Underwriting focus

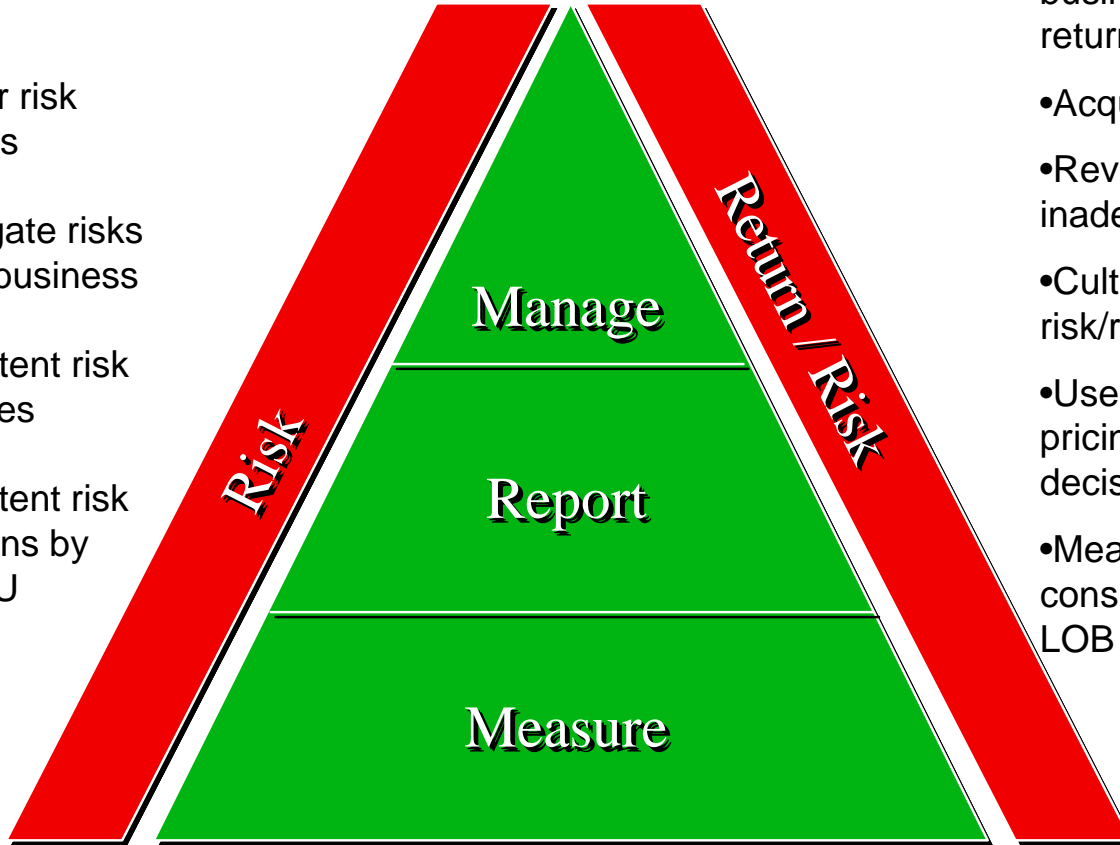
# The Present

- The chief risk officer role and organisational structure
- Risk Measurement frameworks
- Risk Adjusted Performance Measurement
- Increase in risk measurement. A new profession?  
Will the actuarial profession reinvent itself?

# Risk Management Framework

Prudential Regulator & Governance

- Maintain target surplus
- Monitor risk positions
- Aggregate risks across business
- Consistent risk measures
- Consistent risk definitions by LOB, BU



- Invest and Grow business with superior return on risk
- Acquire / divest
- Review operations with inadequate return / risk
- Culturally embed risk/return measures
- Use risk/measures for pricing/ investment decisions
- Measure return / risk consistently by BU, LOB

Drive Superior Performance



# Implementation Challenges

- Lack of dedicated resources
- Lack of expert knowledge
- Determination of methodology and approach
- Management buy in

# Benefits Realised

- Keep pace with requirements to manage risk
- Reduce Capital requirements
- Know what business is likely to meet return or capital targets
- Make the right decisions with confidence using reliable, consistent measures
- Leave the inferior return on risky business to your competitors

# Trends

- Emergence of CRO role
- Formal, separate risk committees
- Implementation of risk measurement frameworks
- Measurement focus has been on the basics
- Measurement techniques mostly unsophisticated
- Significant focus on operational risk

# Reasons for Change

- Regulators applying pressure for more sophisticated risk management
- Governance, legislation, regulation all increasing
- Potential for lower capital requirements by using internal model
- Market demands for return on capital, so must deploy capital effectively
- Capital base limits total risk capacity, therefore businesses choices must be made to achieve risk/return targets
- You cannot manage what you cannot measure

# The Future

- Risk measures consistent across organisation (LOB, BU)
- Return on risk measures used in management performance appraisal and remuneration, pricing decisions and capital allocation
- Actuary as CRO? A CRO professional?
- CRO reporting to CEO and Board?
- Quantitative operational risk models

# Discussion Topics

- The CRO role - way of the future?
- Status of industry - insurance vs banking vs funds management
- Operational risk modelling
- Product Pricing - changing practices
- Practical Challenges
- Diversification - measurement/allowance
- Integrating insurance into a banking framework
- No industry “baseline” solution