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Practical implications of implementing an effective ERM framework

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Agenda

1. What is ERM?
2. Why is ERM important?
3. It’s not about the model
4. Implications of ERM
5. Implementation considerations
6. Getting real value from ERM

What is ERM?

- Various definitions
- **“The methodical management of all material risks.”** - Risk Management Association – The RMA Journal February 2006
- **“Enterprise risk management is a process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”** - Committee of Sponsoring Organizations of the Treadway Commission September 2004

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Why is ERM important?

- Current industry/market challenges
- Rating agency sophistication
- Regulatory attention
- Capital pressures
- Directors' liability
- Competitor positioning
- Market complexity

Do you think it is important?

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Some Initial Questions

- How serious are you about implementing ERM - Big Value but Big Effort
  - Why would you contemplate undertaking this exercise?
    - Risk
    - Regulator
    - Rating Agency
  - Are you taking it seriously?
    - Who is the project sponsor?
    - Has an Non-Executive Director been allocated responsibility?
    - What budget has been allocated to the project?
    - Have you allocated staff to deliver your ERM solution?

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It's not about the model

- It is not just about the model
- ERM is about the business
  - Risk appetite
  - Understanding risk
  - Risk culture
  - Identifying the risks
  - Reporting on risk
  - Quantifying risk
  - Managing the risk
  - Increasing competitive advantage

Risk appetite

- Board and executive responsibility to set the risk appetite
  - In line with strategy and objectives
- Ultimate responsibility remains with the Board and executive management to ensure the risk appetite set by it is filtered appropriately throughout the organisation
- What are the most significant risks?
  - Financially
  - Competitively
- What are the most significant opportunities?

Understanding risk

- Developing a risk register
  - This needs to be owned by the entire organisation
    - Insurance risk
    - Market risk
    - Credit risk
    - Liquidity risk
    - Operational risk
    - Group risk
- Developing a culture within your organisation which understands risk and what risk means to all roles within the organisation
- Identification of emerging risk
- Educating and communicating with internal and external stakeholders so all risks are captured

Quantifying risk

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- Using the risk register as a starting point for the quantification of risks
  - Document the rationale for the quantification of risks
- Operational risk is a challenge for all insurers to quantify but there are benefits from quantifying this risk and the mitigating actions etc, so how are firms approaching it?
  - Model the distribution of risks and scenarios
  - Model risk correlations and ripple effects
  - Contagion effects

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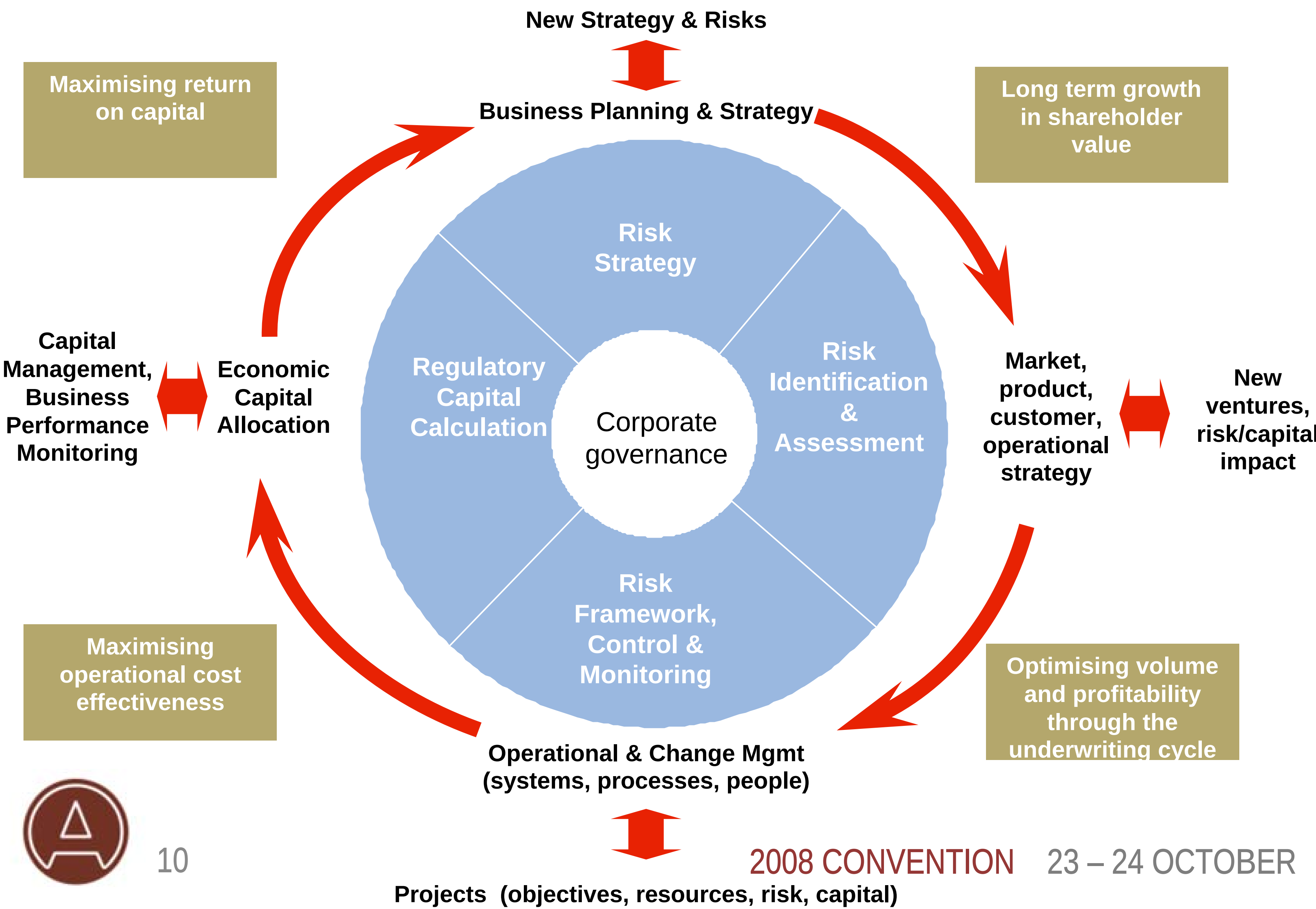
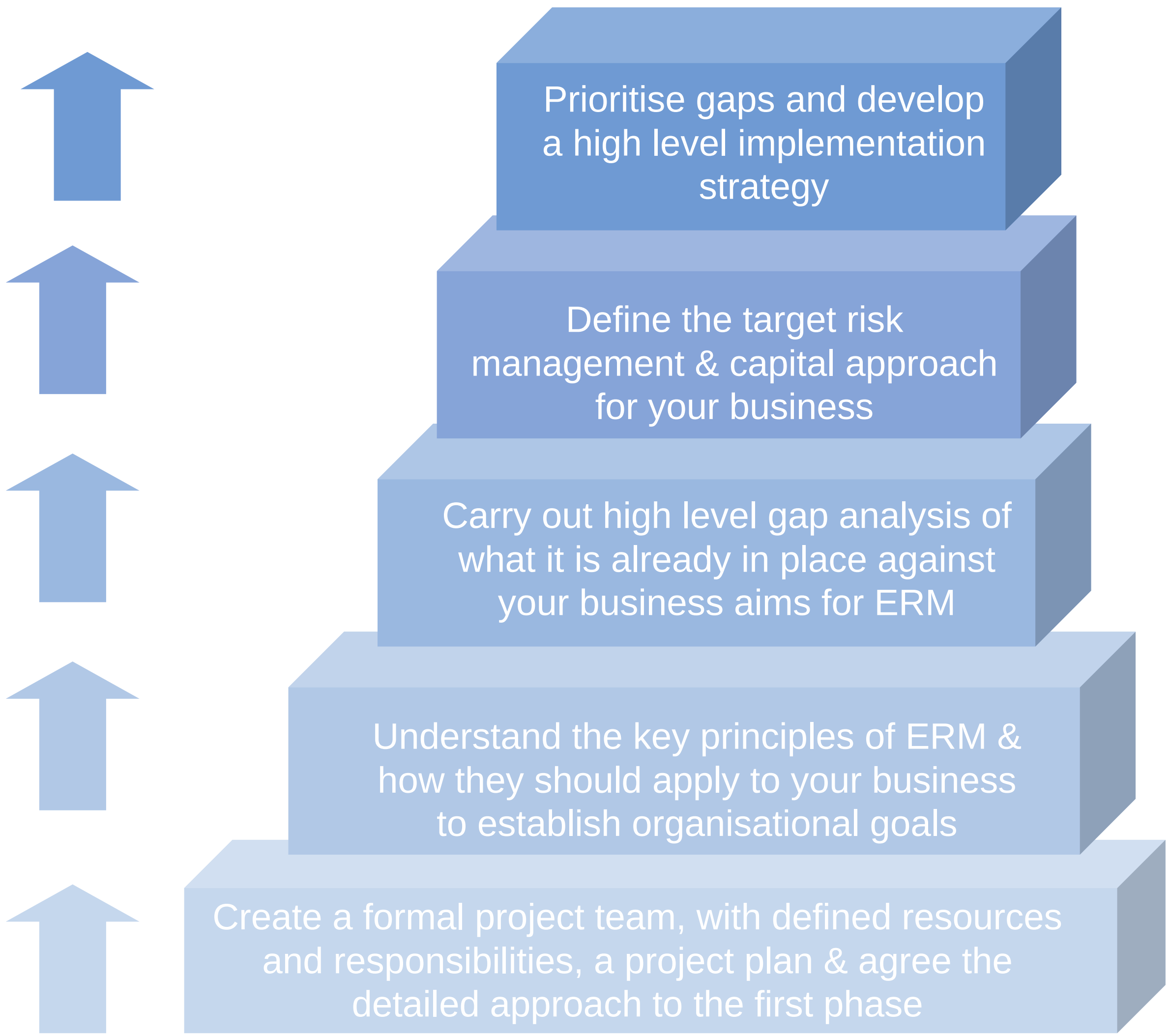
ERM in the business context



Practical implications

Business Requirements	Programme control
Internal and external Requirements and stakeholders	ERM is a 'journey' Rather than a defined End stage
Implementing Cultural change	Impact of evolving ERM developments
Identifying and managing Risk data	Balancing demands & Potential conflicts with Various stakeholders
Demonstrating a well Managed business	Involving people across The whole organisation

ERM where do you start?



The role of the Chief Risk Officer (CRO)

- Created in the wake of new challenges facing businesses, e.g. terrorism, corporate scandals, new regulation (Sarbanes-Oxley etc.)
- Key responsibility:
  - To ensure risk is properly understood and translated into meaningful business requirements, objectives & metrics
- Act as advisor:
  - To the business / Board on risk issues, providing guidance on effective management of key risks to the business
- Main benefit of appointing a CRO:
  - To enable businesses to make better investment decisions by bringing a more effective approach to measuring and comparing risk & reward

Implementation considerations

- Cultural change
- Resources
- Group approach
- Identify and manage overlapping/contradicting regulatory requirements
- Timeliness

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Managing risk – what does this mean in practice?

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- Everyone's responsibility but ultimately the Board and executive management are responsible
- Management of risks must be in line with the risk appetite
- The management of risk must be integrated and operationalised
- Risk management and capital management are the "hot" topics so capital management must reflect the risks of the firm
- Using your understanding of the risks to make informed decisions
- Reporting on risks and using feedback to improve your understanding and management of risks
- Identification of emerging risk

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Embedding ERM into company culture and processes

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- Providing a competitive advantage
  - Knowledge is power when understood
  - Able to identify the risks and the opportunities which may enable you to have “first mover” status
  - Ratings - “S&P assesses insurers’ risk and how the risks are managed”
  - According to S&P the outcome of a fully realised ERM Program is the optimisation of enterprise risk adjusted return info-za@emb.com
- Link compensation and reward to the achievement of risk management objectives at all levels of the organisation

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