Case Study: Keys to Successful ERM Program Design & Implementation

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Common ERM obstacles

- Lack of decision maker buy-in
- Inability to inform decision making

Cause: Suboptimal elements of ERM program

- ERM framework
- Qualitative risk assessment
- ERM models
- Risk scenario development
- Individual risk exposures
- Enterprise risk exposure
- Risk appetite statement
- Risk disclosures to board

ERM framework: Define risk holistically

- Often, risk is defined only as extreme capital decrease
  → Disconnect with strategic plan, incentives, and decision making
- Better to define risk as:
  - Anything causing deviation from strategic plan CFs
    - Links to incentives → buy-in
    - Captures all impacts
    - Satisfies ORSA requirement to link ERM and strategic plan
  - Both upside and downside volatility (full range of scenarios)
    - Supports decision making with risk-reward information
    - Satisfies ORSA requirement to integrate ERM into decisions

QRA: Broad and diverse inclusion

- Often, QRA participation is limited
  → Incomplete key risk list / poorer risk culture / lack of buy-in
- Better if enterprise-wide (corporate and businesses) and mix of levels (executives, lieutenants, mid-level-leaders)
  - Captures all types of risk: strategic, operational, financial, insur.
    - Case: Broad input resulted in broad range of identified risks
  - Satisfies ORSA requirement to capture all material/relevant risks
  - Enhances risk culture and buy-in
- Case:
  - Risk is now a part of everyday dialogue/decision making
  - Executives embraced this, seek inclusion in these processes

QRA: Guided interviews

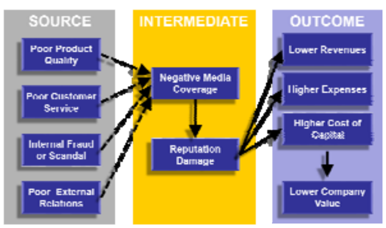
	Templates	Guided Interviews
Relationships	Damaged: Impersonal, delegated assignment	Enhanced: Respectful, collaborative effort
Level of effort	Inconsistent	Consistent
Quality	Low; written guidance often unread or misunderstood	High; interactive live guidance

- Case:
  - Convey key messages to secure buy-in, re-direct mistaken impressions
  - Build relationships
  - Enhances risk culture
  - Solidifies risk vocabulary

QRA: Define risk consistently by source

- Risks often defined by outcome or intermediate outcome
  - Reputation risk
  - Ratings downgrade
  - Decrease in profitability
- Results in problems
  - Participants scoring different risk sources → unusable results
  - Incomplete risk scenario → underestimate impact
  - Lack of connection to real world → not credible → lack of buy-in
- Imperative to define risks consistently by source
  - Consistent scoring
  - Complete and credible scenarios

QRA: Define risk consistently by source (cont.)



- Case:
  - Clarifies understanding of the risk, including, for example, differentiation of pre-event versus post-event mitigation opportunities

QRA: Define credible-worst-case scenario

	Common Practice	Best Practice
Risk Scenario Guidance	▪None: Armageddon? Most-likely scenario? ▪Participants all scoring different risk scenarios	▪Define a single credible worst-case scenario ▪Participants all reacting to identical risk scenario

- Case:
  - Provides guidance to interviewees, particularly non-quants
  - Level sets understanding across all participants

ERM models: Practical

	Complex	Practical
Model risk	High	Low
Response time	Slow	Fast
Transparency	Low	High

- Practical models gain more buy-in and traction with decision makers
  - Supports ORSA requirement to integrate ERM into decision making
- Case:
  - Importance of transparency in gaining buy-in
  - Power of "what-if" modeling and fast turnaround
  - Practical higher-level independent model provides model validation

Risk scenario development: Deterministic

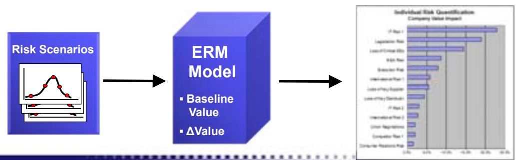
- Stochastic scenarios often directly input into ERM model
- Better to develop deterministic scenarios based on all available info (including stochastic):
  1. Leverages your smart people's knowledge/judgment (article)
     - o Case: Credibility
  2. More dynamic (also satisfies ORSA's "dynamic" requirement)
  3. Transparent (one-pagers) → buy-in → used in decision making
     - o Case: Engagement
  4. Fewer errors/bias via documentation/sharing (cases: hurricane reinsurance, direct marketing costs, Operation Eagle Claw)
  5. Enhances risk culture: Engages more people in the process
     - o Case: Connecting with business units / Socializing baseline

Risk scenario development: Value-based

- Capital-centric and other extreme downside-only ERM frameworks often fail to generate buy-in
  - Not connected to day-to-day concerns of the business
- Value-based approach engages people by addressing what they care most about:
  - "What obstacles do we have to achieving Plan?"
  - "How might we exceed Plan?"
  - "How can this process help me achieve my goals?"
  - "How can we make the business case for doing things we know needs to be done?"
- Case: "Stealth" buy-in

Individual risk exposures: Quantify all risks

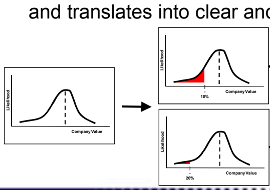
- Often, only financial/insurance risks are quantified
  - → Decisions related to strategy and operations not supported
  - → Quantifying enterprise risk exposure not possible
- Value-based approach quantifies all risks consistently
  - – Case: Comprehensive engagement



Enterprise risk exposure: Quantitative

- Often, enterprise risk exposure is not a fully quantitative expression including all sources of risk
  - → Not representative of full volatility → proper actions unclear

→ Value-based approach allows full quantitative expression and translates into clear and understandable information



"Pain Point"	Likelihood
ΔValue ≤ -10%	15%
ΔValue ≤ -20%	3%

Modified Case Study

Enterprise risk exposure: Quantitative (cont.)

"Pain Point"	Likelihood
Decrease in company value of more than 10%	15%
Ratings downgrade – one level	7%
Falling short of Plan revenue growth by more than 200 basis points	11%
Falling short of Plan earnings by more than 2¢ per share	10%

Risk appetite statement: Quantitative

- Many risk appetite statements lack a hard quantitative expression of the limit on enterprise risk exposure
  → Not representative of full volatility
  → Not actionable
- Value-based approach allows quantitative expression that can be directly compared to enterprise risk exposure
- Case: Rock star output

Modified Case Study

Risk appetite statement: Quantitative (cont.)

PAIN POINTS		LIKELIHOOD	RISK APPETITE
ΔValue			
Increase of at least	0%	32.5%	
Decrease of at least	-10%	36.3%	
Decrease of at least	-20%	13.8%	**20%**
Decrease of at least	-30%	2.0%	
ΔGrowth (5-Yr Prem CAGR, bps)			
Increase of at least	0	29.5%	
Decrease of at least	100	46.1%	
Decrease of at least	200	26.9%	
ΔCapital (5-Yr Calls on Parent, $M)			
Not more than	0	55.2%	
Equal to or greater than	50	24.5%	
Equal to or greater than	100	13.3%	**20%**
Equal to or greater than	150	2.9%	

Risk disclosures to board: Understandable

- Often, board disclosures are abstract (lack of connection to strategy, esoteric math, etc.) and incomplete (not all risks included or quantified)
  → Board lacks full understanding of ERM program implications, including risk appetite, and strategy is not properly aligned
- Value-based approach clarity, practicality, and strategy connection engages and properly informs the board
- Case: Critical buy-in

Contact information

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