

ORSA Updates, Issues, Opinions, Debates – A Socratic Dialogue

**CAS CLRS Seminar ERM-3
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Agenda

- OWN RISK solvency assessment
- Common Issues
- Leveraging Efforts
- Splitting the CRO Job

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OWN RISK solvency assessment

- Drivers of Enterprise Risk Management
 - Internal, not regulators
- Concentration Risk
- Leveraging ORSA to add value

ORSA Background

- Can't rely on regulators to manage risk
 - Dodd Frank: designed for banks by banks
 - Risk Focused Examinations (RFE): checklist
 - Sarbanes Oxley: who to fire
- Corporate culture: hindsight is easier
- Long time horizon
- Stable periods allow risks to grow

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Common Issues

- Culture - Enron
- Accountability – hedge funds
- Incentives - banks
- Exposures/correlations in the tail - RMBS
- Leverage - LTCM
- Systemic risk/liquidity - 2008

Concentration Risk

- Decision making
- Exposures
 - Geographic
 - Asset class
 - Product
- Won't show up in stochastic modeling

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Leveraging Efforts

- Build off of DFA/business plans
- Test strategies/tactics
 - Acquisition/divestiture
 - Organic growth
 - Scenario/Stress tests
 - Stochastic/deterministic
 - Quantitative/qualitative
 - Emerging risks

Model Issues

- Procyclical results
- Correlations are not stable over time
- Historical data may not represent future
- Reliance on statistical representations
- Liquidity/Reputation
- Net exposure versus gross

Model Issues

- Black box
- Single number product
- Herd mentality – mitigation/modeling
- Risk appetite is not stable over time
- Cookie cutter risk mitigation strategies

Solutions

- Realistic stress testing
- Exposure database crossing products/assets
- Contrarian thought
- Healthy dialogue with alternative views

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Splitting the CRO Job

- ERM process owner
 - Rotate with product line responsibilities
 - Own the process, not the risks
 - Incentives should not tie to financial results
- Chief Risk and Return Officer
 - Strategic planning
 - Upside as well as downside
 - Interact with CEO/board/modelers

Skill set of CRRO

- Emerging risks
- Interactions between risks
- Unintended consequences
- Willing to share ideas/concerns
- Big picture/holistic

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