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Practical Enterprise Risk Management (ERM)

Casualty Loss Reserve Seminar, Fall 2013



Agenda

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ERM 101

What is ERM?
ERM can integrate siloed risk management efforts to focus organization on key risks

The diagram shows a blue arch labeled "Enterprise Risk Management" at the top. Below it is a green bar with the text: "ERM leverages and connects existing risk management efforts by providing a common language for risk, risk appetite and risk management strategies across the organization". Underneath is a row of vertical blue bars representing various business functions: Quality, Research, Compliance/Regulatory, Safety, Information Technology, Treasury, Legal / Insurance, Internal Audit, and Human Capital. To the right of these bars is a text box: "ERM can assist in: • Aggregating and rationalizing most significant risks • Coordinating and communicating responses to those that merit greater attention". At the bottom is a blue bar labeled "Strategy / Business Planning".

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Why ERM?

An effective ERM program may help:

- Identify and manage cross-enterprise risks
- Create a risk-aware culture
- Enable focus on the risks that matter most through integrated management reporting
- Reduce vulnerability to adverse events
- Align risk appetite and strategy
- Link growth, risk, and return
- Decrease operational surprises and losses
- And more...

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How to build an effective ERM program

3. Develop risk appetite Illustrative

Sample speed of onset rating criteria

| Criteria | Definition |
|----------------------|--|
| HIGH (4-5 Rating) | Very rapid onset; little or no warning; instantaneous. |
| MEDIUM (3 Rating) | Moderate onset; several days or weeks to occur. |
| LOW (1-2 Rating) | Very slow onset; several months or years to occur. |

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4. Assess & prioritize risk Illustrative

Risk : Impact + Vulnerability + Speed of Onset

What can happen?

- Financial
- Reputation
- Legal
- Customer
- Coworker
- Partners

How prepared are we to react?

- Mitigation Plans
- People
- Process
- Technology

How quickly could it happen?

- How much time would we have to react?

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Risk appetite/tolerance discussions with executives and board will help define "High", "Medium" and "Low" for each of these components

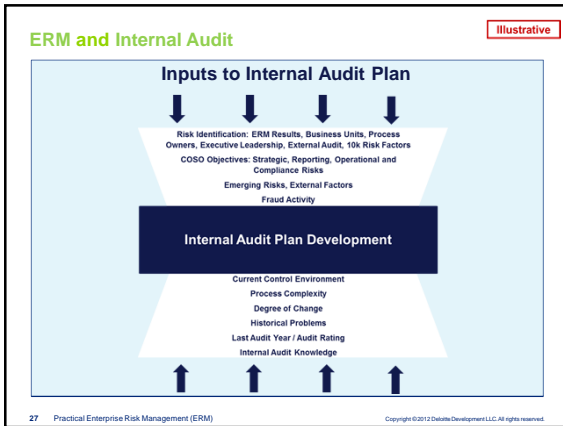
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4. Assess & prioritize risk Illustrative

| ID | Risks |
|----|----------------------------|
| A | Foreign Exchange Rate |
| B | Competition |
| C | Transfer Pricing |
| D | Debt Management |
| E | Contracts |
| F | Financial Accounting |
| G | Information Security |
| H | Capex Management/Liquidity |
| I | Regulatory Compliance |
| J | Quality |
| K | Succession Planning |
| L | Reputation |
| M | Intellectual Property |
| N | Insurance Coverage |

Dot size reflects Speed of Onset: Low (small blue dot), Medium (medium green dot), High (large red dot)

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Case study

Case – risk self assessment manual Illustrative

Client
A large Financial Services firm (Firm B)

Background
Firm B was seeking to develop a Risk Self-Assessment (RSA) Manual to be used within the business units (BU) to enable specific and consistent methodology for the assessment of risk.

Project Sponsor
Chief Risk Officer (CRO)

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Case two – risk self assessment manual Illustrative

- Enhanced existing enterpriserisk map
- Developed a risk rating criteria to be applied by BUs in assessing risks
- Leveraged existing Firm B and Deloitte tools, developed and documented a process and supporting templates for the risk assessment, including:
 - Overall procedures and protocols
 - Facilitation (survey) questions to be used in the BU RSA process
 - Templates to support risk identification, assessment and reporting processes, e.g., risk register, risk/opportunity heat map, reporting & analysis dashboards, etc.
- Developed a change management plan to increase the probability of successful adoption of the RSA manual and lay the groundwork for adoption of future ERM enhancements
- Designed and assisted with pilot BU RSA workshop

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Case two – risk self assessment manual Illustrative

Risk Rating Criteria

Impact Rating Criteria – Example

| Impact Rating | Low (LFI) | Medium (MI to MFI) | High (HFI) |
|-------------------|-----------|--------------------|------------|
| Sales | < \$1M | \$1 M-\$1.5M | > \$1.5M |
| Earnings | < \$1M | \$1 M-\$1.5M | > \$1.5M |
| Statutory Capital | < \$1M | \$1 M-\$1.5M | > \$1.5M |

Participants should rate the impact of each risk in the following financial categories:
 - Sales
 - Earnings
 - Statutory Capital
 The percentage impact should be based on the prior year-end value of each financial category.

Likelihood Rating Criteria

| Likelihood Rating | Description |
|-------------------|---|
| HIGH | >50% chance of occurring within the next three years |
| MEDIUM | Between 20% and 50% chance of occurring within the next three years |
| LOW | <20% chance of occurring within the next three years |

"Likelihood" refers to the probability of a risk event occurring within a specified time period. This is a subjective assessment; it is understood that estimating the likelihood will be difficult for many of the categories. Participants may wish to consider whether there has been any history of similar incidents in the past.
 Following an open discussion of each risk, workshop participants should endeavor to quickly reach a consensus about the assigned likelihood.

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Case two – risk self assessment manual Illustrative

RSA Process

Process

- Risk Identification and Assessment
 - Create Risk Register
 - Prioritize risks using Risk Rating Criteria
 - Use Heat Map to identify high priority risks
- Risk Quantification and Reporting
 - Quantification of
 - 3 yr earnings impact (\$ mm)
 - Sales impact (\$ mm)
 - Statutory Capital impact (\$ mm)
 - Likelihood (% chance per year)
 - Qualitative assessment of velocity
 - Suggested action plan
 - Cost of action plan
- BU Planning / BU Review
 - Integration into BU business plan
 - Additional summaries for BU review
- Enterprise Aggregation
 - Aggregation by risk category
 - Correlation adjustments
 - Development of enterprise action plans

The results from the annual process will also be utilized in the October and March BU reviews, supplemented by

- Updates on the action items for each high-priority risk
- Description of any significant risk events during the trimester
- Discussion of any newly identified or emerging risks
- New action items or recommendations

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Potential challenges

- ERM training is still limited to risk specialists and people directly involved in the Risk Management activities
- Just in this past decade, many companies' failures were the result of bad decisions on the part of a handful of people – in these cases, the human factor is the root cause
- In the midst of the recent economic challenges, many companies with well-established ERM functions, processes, and controls still failed
- Missing the cultural and organizational components that may help guard against ineffective or just plain poor decision-making on the part of individuals
- ERM processes are implemented but organizations may still face challenges with respect to effective monitoring and reporting
- Lack of awareness is a common barrier to effectiveness

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Current trends

- There is increasing link between risk and performance management
- More emphasis has been put on risk related to strategy and its execution
- The focus is shifting from the unrewarded risks to the rewarded risks
- The role of HR in managing risk is expanding
- Social media risk rivals financial risk as an area of concern
- Continuous risk monitoring is rare today, but on the rise
- The Changing Role of Internal Auditors is not just focused on risk mitigation but also value creation
- Data integrity and data analysis become increasingly important as systems are integrated and reporting needs increase
- Boards have been increasingly proactive in risk management and this will likely continue
- The CRO is increasingly a more senior executive position

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Q&A



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