



## **Killer Risks: Torpedoes in the Water**

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### **Killer risks**

- Arrogance
- Rainmaker
- Mastermind
- External power concentration
- Internal communications
- External communications
- Tail risk myopia
- Combination punches

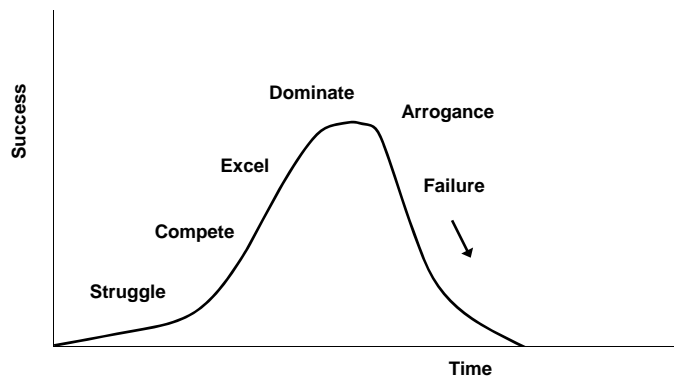
## Most killer risks share 3 qualities

- Politically difficult to introduce
- Easily identifiable
- Leading indicator of high-severity risk events

## Arrogance

- Attitude of invincibility
- Politically difficult
- Easily identifiable
  - Insular attitude
  - Lack of self-criticism
  - Overly-praising of self
  - Overestimation of strengths / underestimation of vulnerabilities

## Leading indicator of high-severity risk events



## Examples

- Swiss watchmakers
- United States post WWII/Sputnik
- General motors

## Possible mitigation

- Focus on weaknesses resulting from the behavior, not the behavior itself
  - Unrealistic strategic plans
    - Address by integrating ERM into strategic planning
      - Identifies disconnects (assumptions, trend lines)
      - Validates (likelihood of achieving Plan?)
      - Risk scenarios clarify what is in (or not in) baseline
    - Lack of competitive analysis, benchmarking
      - Address directly through business segments
      - Address indirectly through emerging risk identification

## Rainmaker

- Individuals or business units generating very high growth
- Politically difficult
- Easily identifiable
  - Peacock-like attitude
  - Highly compensated

## Leading indicator of high-severity risk events

- Typical progression
  1. Recognition of talent
  2. Massive, rapid growth
  3. Implosion
- Why does this occur?
  - Lack of scrutiny
  - Pressure

## Examples

- Long Term Capital Management
- Fukushima
- David Sokol

## Possible mitigation

- ERM policy to automatically enhance scrutiny with abnormally high growth
  - Risk and return go together
  - Automatic nature avoids direct confrontation
- Value-based ERM approach
  - Blunts argument that value generated overwhelms any risk concerns
  - Use as entrée to quantify both value and risk

## Mastermind

- Individuals with unique intelligence/mastery in area of expertise
- Politically difficult
- Easily identifiable
  - Highly respected and widely known both internally and externally

## Leading indicator of high-severity risk events

- Create a large vacuum when they leave
  - Difficult to replace the individual
  - Tend not to share information
  - Tend not to develop people under them
- If stolen by competitor, doubly impactful

## Examples

- CFO of large financial services company
- Steve Jobs

## Possible mitigation

- Raise as talent management issue to mitigate “rare talent concentration risk”
  - Emphasizes valuable nature of individual
  - Committee approach to identifying individuals
- Leads to enhancements:
  - Succession planning for mastermind
  - Establishment/development of supporting cast
  - Documentation/sharing of critical information

## External power concentration

- Disproportionately high concentration of power in an external party
  - Critical supplier, large customer/distributor
- Politically difficult
  - Challenges powerful entities and their powerful internal allies
- Easily identifiable
  - Management is well aware of these



## Leading indicator of high-severity risk events

- Should they be lost, either partially or entirely, there is a large impact, proportional to the concentration

## Examples

- Bernie Madoff
- Monoline insurer

## Possible mitigation

- Quantify to reveal true impact on value
  - May lead to diversification strategy
    - Example: Cleaning products manufacturer
  - May result in corporate support of business segment initiatives to maintain the relationship

## Internal communications

- Failure to share risk scenarios horizontally or vertically in the organization
- Examples
  - September 11th
  - Space shuttle disaster
  - Operation Eagle Claw
- Possible mitigation
  - Formal robust risk scenario development process
  - Formal meetings between risk committees

## External communications

- Failure to properly disclose risks to shareholders
  - The single most overlooked risk
- Example
  - Banks
  - Research study
- Possible mitigation
  - Quantify risk scenarios in terms of their potential impact on company value

## Tail risk myopia

- Limiting focus to just worst-case scenarios
  - Often misses even more severe exposures (worst-case not found until range of scenarios quantified)
- Possible mitigation
  - Formal robust risk scenario development process

## Combination punches

- Multiple events occurring simultaneously
- Examples
  - Financial crisis
  - Monoline
  - Fukushima
- Possible mitigation
  - Quantify multiple simultaneous risk scenarios

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