



**A.M. Best's Rating Criteria
ERM, Capital Models & SRQ**

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Thomas M. Mount, ACAS, MAAA




Discussion

- *Enterprise Risk Management*
 - *General criteria overview*
 - *BCAR model vs. internal capital models*
 - *New Supplemental Rating Questionnaire questions*



Enterprise Risk Management



What is Risk Management?

- *Let's keep it simple...every company does some form of risk management*
- *AMB defines risk management as the risk and capital management process(es) and practice(s) employed by a company*

Risk Management = (Identify + Understand + Measure + Manage) Risk

- *No two companies are exactly alike*
- *AMB's assessment of risk management respects the unique nature of every company we rate*



AMB Approach is Evolving

- *AMB's approach to risk management remains consistent but is evolving*
 - *"E"nterprise Risk Management – Holistic view of risks across the enterprise including correlations and interdependencies*
- *AMB is re-affirming our commitment to the fundamentals of our core rating methodologies and the treatment of risk management within the rating process*
 - *Risk management must be viewed within the broader rating context*
 - *Assessment of risk management is not a separate process*
- *Remain true to our original methodology*
 - *Risk management is not "one size fits all"*
 - *Discipline, common sense and patience are the most important elements of risk management*



Executive Summary

Our goal is to get the **conversation** back on the core analytical process and create a **common platform** that applies to all insurers...large and small

- **Conversation**...the credit rating process, including the assessment of risk management, is interactive
 - Two-way dialogue on the key rating factors
 - Recognizes there are many different paths to success
 - NOT prescriptive...NOT driven by buzz words
- **Common platform**...the underlying fundamentals of the credit rating process, including the assessment of risk management, should apply to all entities we rate



Risk Management Spectrum



- **Wide spectrum of risk management tools, techniques, and approaches**
- Differences in geographic and product complexity/diversity, as well as management team skill sets and mind sets, must be considered
 - Approaches range from a traditional "silo" mentality to an integrated ERM platform with ICM, with many hybrids in between
 - Companies may migrate from one approach to another over time as their profile, skill set and the business environment changes
- **Bottom line: a company's process must fit its profile and provide a stable, sustainable operating platform in good times and bad**



AMB is Looking for a Practical Approach to Risk Management

- **Tailored to your business and risk profile**
 - Process must fit your company, not the other way around
 - Pick the right tool for the job, not just the most expensive one
 - Risk management will be defined differently by each company
- **Function over form**
 - CRO's and sophisticated models are not absolute pre-requisites for strong risk management
 - For some insurers, strong risk management may be a more traditional approach supplemented by an understanding of how risks correlate
- **Flexible and adaptive to the changing business environment**
 - Strong risk management is not a finitely defined set of tasks
 - Ongoing process...emerging risks...risk learning



Risk Management and the Rating Process - A Practical Approach

- **An open-ended and open-minded assessment of each company's operating practices that does not pre-judge the effectiveness of a company's approach to risk management based on a predetermined expectation**
- **AMB wants companies to "show me" how your risk and capital management process provides a stable, sustainable operating platform that can weather the storm year after year**



Risk Management and the Rating Process...

- *Top 5 Exposures and Critical Success Factors to Mitigating/Managing these Risks*
- *Lessons Learned through your Risk Management Development Process*
- *“Risk Management Questions You Should Address at Every Rating Meeting”*
- *Next Steps in Risk Management Development*

AMB recognizes risk management is an ongoing process.
Demonstrating commitment and progress toward a goal is the key.



Questions You Should Address at Every Rating Meeting

- *What is the Board's and Senior Management's role in your risk management framework?*
- *Has your organization established and communicated any risk management objectives to your employees, and other stakeholders?*
- *What is your risk appetite? How is it measured?*
- *How does your organization encourage good risk-based decision making?*
- *What is your organization's process for identifying and cataloging key risks across your organization?*



Risk Appetite

- *How much of your capital or earnings or (name your metric) are you willing to lose or put at risk?*
- *Is your management team inherently risk-taking, risk-averse, or risk-neutral (approach depends on the situation)?*
- *If you formally establish a risk appetite, how do you do that?*
- *Once you've established your overall risk appetite, how do you "slice the pie"?*



Questions You Should Address at Every Rating Meeting

- *What tools does your organization use to determine required capital? Is it a static, dynamic, or hybrid approach?*
- *How do you factor in correlation/dependency of individual risks?*
- *How are liquidity, cash flows, and financial flexibility incorporated into your risk management framework?*
- *How do you incorporate operational risk and strategic risk in your evaluation of required capital?*
- *How are emerging risks identified and evaluated?*



What Should You Share with AMB?

- *Provide AMB whatever materials you feel will help us understand how your organization defines and strives for strong ERM*
 - *Demonstrate how you identify, understand, measure and manage risk*
 - *Sample reports used by Board, senior management, etc.*
 - *De-briefing on how risk tools were used to make a strategic or tactical decision...the USE TEST!*
 - *Internal or external assessments of your overall process, or components of your process*



Determining Required Capital (Let's Talk)

- *Determination of required capital is be based on an interactive dialogue comparing*
 - *Company's view of capital (e.g. ICM)*
 - *BCAR score and historical trends*
 - *Holding company issues*
 - *Other models or metrics*

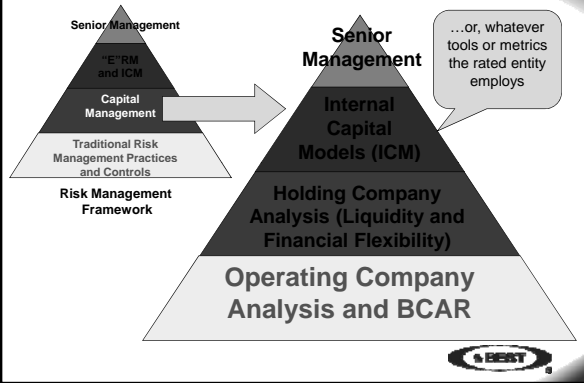


ICM Approach – Integrated within ERM Discussions

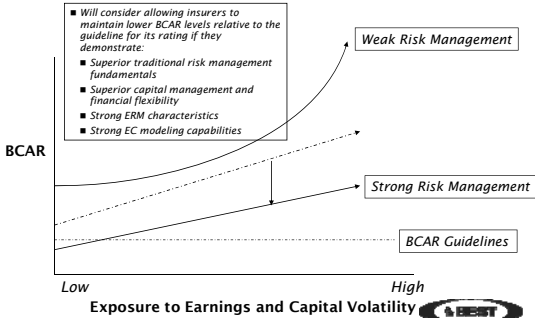
- *AMB dialogue on capital management includes a review of key underlying elements of ICM process and results, or whatever tools or metrics the company uses to determine required capital*
- *Incorporated within the credit rating evaluation process, either at annual rating meeting or as a supplement to annual meeting*
- *AMB discussion/review is not an "audit"*
- *Objective is to better understand the underlying drivers of the differences between view of risk-adjusted capital per your ICM or other metrics used vs. BCAR*




Capital Management Framework



Enterprise Risk Management



ERM – SRQ Questions



Enterprise Risk Management SRQ Questions

Serve as a consistent starting point for analyst's discussion about the rating unit's risk management


- Cover main areas
 - Risk Culture
 - Risk Identification/Measurement/Monitoring
 - EC Models/Use Test
 - What If Scenarios



Enterprise Risk Management SRQ Questions

Risk Culture

- Do you have a CRO / ERM committee?
- Are your strategies driven by risk/return measures?
- How often does the Board review risk tolerances?
- How often does the CRO / Senior Officer report risk metrics & risk management activities to the Board?
- How often does the CRO / Senior Officer report risk metrics & risk management activities to the business units?



Enterprise Risk Management SRQ Questions

Risk Identification/Measurement/Monitoring

- Who is most responsible for identifying material risks?
- What has management identified to be its largest threat?
- At what level do you define risk tolerance?
- What is management's overall tolerance for risk?
- Who is most responsible for monitoring risk tolerances?
- How often are the material risks measured?
- Who receives exception reports when risk tolerances are exceeded?
- Are there procedures if tolerances exceeded?
- Largest accumulations of risk at a location or an account
- What lines are most correlated that could threaten strength?



Enterprise Risk Management SRQ Questions

Economic Capital (EC) Models

- Do you use an EC model to quantify your aggregate risk?
- If an EC model is not used, how do you determine capital adequacy and allocation of capital to business units?
- Do you use the EC model to make key business decisions?
- Do you use the EC model to determine any portion of management compensation?
- What are the 3 key drivers (or parameters) of the EC model that have the greatest impact?
- How often are these drivers of the EC model updated?
- How often is the EC model run?



Enterprise Risk Management SRQ Questions

What If Scenarios: Impact of Changing Inflation/Interest Rates

- Do you estimate the potential impact of future changes in general inflation (P/C) or interest rates (L/H) on your current net loss reserve (P/C) or capital (L/H) position?
- How often? By Whom?
- Please describe 3 potential future general inflation / interest rate scenarios that your company has identified as stress scenarios for the company
 - Quantify the likely (\$) impact
 - Describe mitigation strategy



Questions & Comments

Welcome

thomas.mount@ambest.com