CRO PANEL: Perspectives on ERM

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Enterprise Risk Management: Potential Issues

- Key word is "Enterprise"
 - i.e. look at the whole company, both sides of the balance sheet
- Two potential key issues:
 - Consistency between different sides of the balance sheet
 - i.e. liabilities vs. assets
 - Possible interactions between risks on the liability side & asset side

Consistency of risk/reward

- Corporate Bonds
 - Spread: OAS = Option Adjusted Spread
 - Microsoft (AA+) 5 year bonds: OAS = 20bps

- Cat Risk
 - -ROL=?

Consistency in assessing tail risk

Cat risk

- 100+ years of historical data
- Assess 100 yr/250 yr PMLs

Asset risk

- Most widely used risk model
- Looks at 3-5 years of data (recency bias)
- Exponentially weighted (more recency bias)
- Assumes normal distributions with mean/covariance framework
- 2008 crisis is already a distant memory,

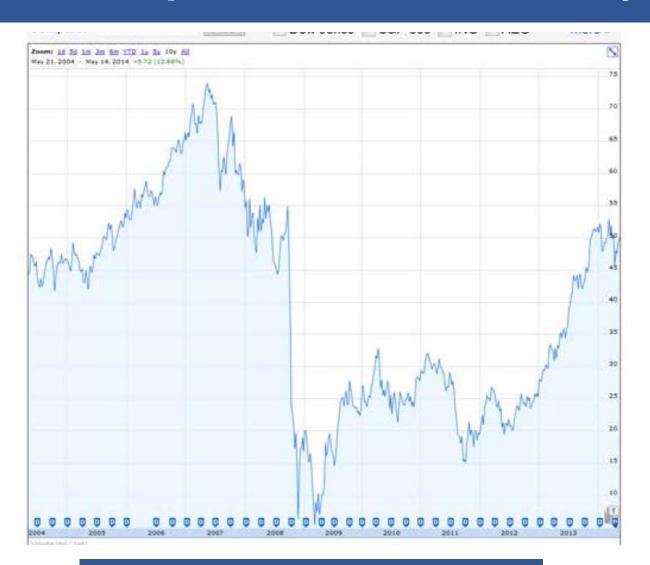
Potential for Interactions

- How might asset side & liability side interact?
 - i.e. both get hit at the same time, doublewhammy
- What external factors could negatively impact both?
 - Is correlation approach the best?
 - Event/scenario driven approach?

Asset/liability sides of the B/S

- Life Insurers in 2007-2009 Credit crisis
 - Some got hit on both sides of B/S
 - A few took TARP Money
 - Assets: structured/"risky" bonds
 - Embedded equity market risk
 - CDOs etc.
 - Liabilities: Variable annuities and similar products
 - Embedded equity market risk
 - Effectively sold equity put options to policyholders
 - Risk not fully hedged

Example: Stock Price History



Could P/C (re)insurers be hit with a double-whammy?

- What are some potential candidates?
- Cat risk and Muni bonds?
- Inflation?
 - Inflation sensitive liabilities
 - Nominal bonds
- Surety insurance and corporate bonds
 - -Enron scenario