

# Aligning ERM with Strategy

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# About the speakers

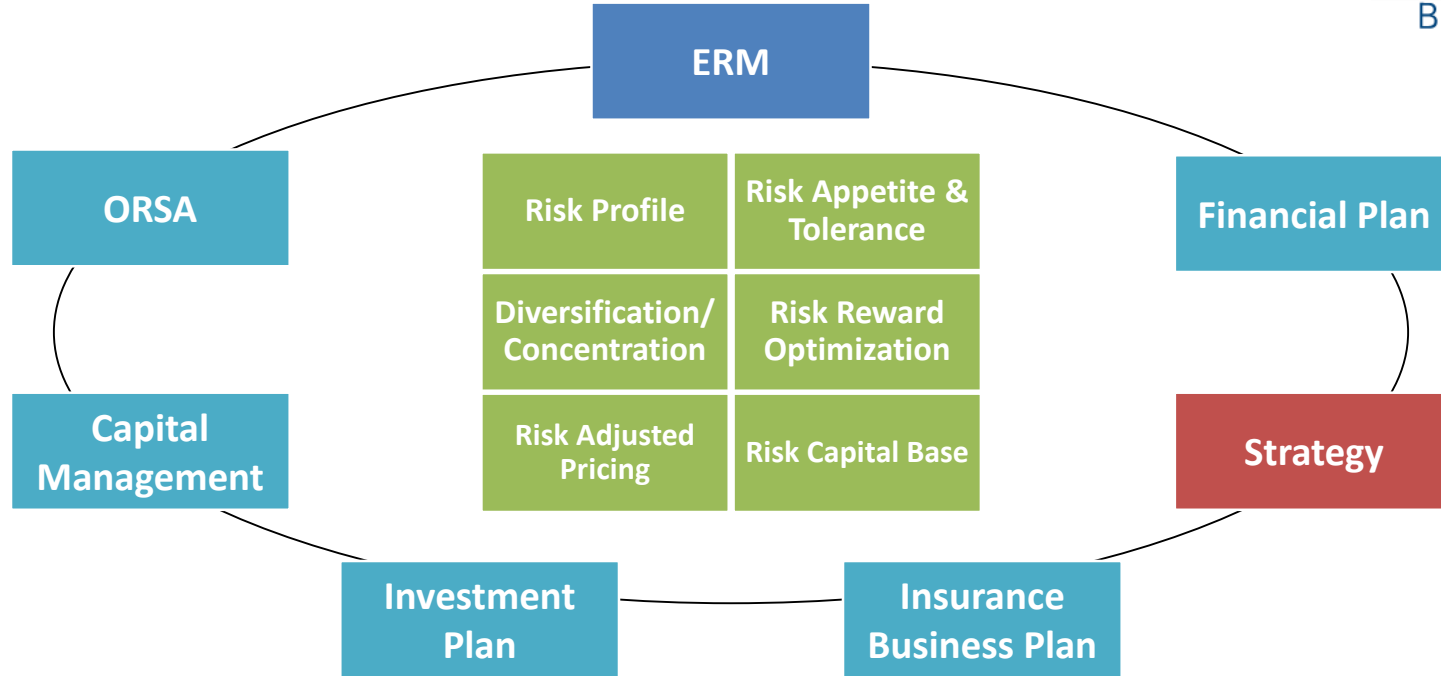


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- Chair, CAS Risk Management Committee, former chair of ERM Symposium Program Committee

# Linking ERM with Corporate Strategy and Plans



# Strategy + ERM Study

## Summary of Findings



We have found that ERM is often not aligned with Strategy at all, sometimes not even linked with Planning

Several Study Participants said that ERM is at a crossroads

- Can end up as a good compliance and loss reduction service
  - Which some are concerned may be the current path
  - Or ERM can adjust course and work to align with Strategy and Planning

# Methodology of this Report



WTW conducted interviews with 20 North American insurers, including

- global insurers, national insurers, regional and single state.
- Stockholder owned and Mutuals;
- Single product and multi line.

We asked the following basic questions:

1. What role does ERM play in insurer strategy discussions?
2. What ERM products/tools are important to strategy discussions?
3. What could ERM do to improve effectiveness in Strategy work?

*We collected over 100 ideas of what works well, what is not working, and what needs to be changed. Today we will feature just a few of those ideas.*

# Common Challenges found with Effective Alignment of Strategy & ERM



- ERM uses specific jargon
- ERM concentrates on downside analysis and existing risks
- Key focus of Strategy is competitors
  - Competition is often not a factor in ERM considerations
- Most important ERM insights often contradict common knowledge
  - May be disbelieved because of that
- ERM produces information on its own schedule – without regard to strategy/planning schedule
- Too much of ERM analysis is backwards looking
- Does too little to help break down silos within insurers

# Top 10 Ideas From Our Discussions



Process (4 ideas)

Culture & People (4 ideas)

Objectives & Strategy (2 ideas)

**We will highlight 5 of these**

# Process

## Coordinate ECM schedule with Planning schedule



- ECM reports provide valuable information for strategy discussions
- Many modeling teams do not align their schedule with Planning schedule
  - Not uncommon for ECM Reports to be presented to Board months *after* adoption of Plan
    - Data constraints
    - Different priorities of modeling team
- If driven by model complexity, then perhaps change ECM
- If driven by data or resource constraints, then align schedules

## Process

### ERM should provide due diligence of risk and risk control for new products, acquisitions, etc.



- A new strategy will usually mean creating a new product, going into a new territory, acquiring a company, add a new distribution system
  - Someone will be tasked with assessing the potential to achieve the objectives for new sales or customers or whatever
  - Someone will be tasked with assessing the likely costs of the new activity
  - Someone will be tasked to assess the ability to charge enough premiums to achieve profitability
  - A key strategic role for ERM would be to assess the risk, proposed mitigations & controls and expected profit compared to the risk

# Process: ERM New Strategy Assessment (continued)

## Examples of Questions



- What are the inherent risks of the new strategy?
  - Are those risks adding to the insurer's highest risk concentrations or are they diversifying?
  - Key risks to delivery/implementation of the strategy?
- What mitigations and controls are proposed?
  - Do these require new expertise?
  - What is the impact of new strategy on risk profile with mitigations in place?
- How do the residual risk level compare to other current activities
  - Risk / Premiums – Average, range
  - Risk / Asset Value – Average, Range
- How do the expected profits compare to risk?
  - Year 1
  - Year 2
  - Year 3
  - When is Return on Risk expected to be comparable to current activities

## Process: ERM New Strategy Assessment (continued)



- Are we prepared to monitor :
  - compliance with proposed mitigations & controls?
  - Amount of additional risk?
  - On a timely enough basis to catch and fix any problems?

# Objectives & Strategy

## Use risk analyses to look for new opportunities



- ERM often focuses on why highest risk activities are so high (with limited consideration of reward), and suggesting ways to write or retain *less* of that business
- Could also examine the characteristics of highest risk reward activities and suggest ways to write or retain *more* of that business
- Look at how existing activities can be adapted to move them closer to the efficient frontier
- **Help to identify characteristics of new activities that align with strategy, appetite, and tolerance**

## Culture & People

### Use the same language that businesses use



- ERM experts have often spent much time learning and explaining to management a long list of ERM terms
- But in many cases management fails to incorporate the ERM vocabulary into their own general usage

# Culture & People

## ERM Specialty Language - Examples



Conditional Tail Expectation (CTE)	Return On Risk-Adjusted Capital (RORAC)
Control Cycle	Risk Aggregation
Covariance	Risk capital
Deficit Capital	Risk culture
Deterministic Models	Risk Mapping
Economic Capital	Risk Metric
Economic Value Added (EVA)	Risk Owner
Embedded Value	Risk Profile
Emerging Risk	Scenario Test
Excess Capital	Shortfall Risk
Group risk	Stochastic Models
Limit breaches	Tail Events
Probability of Ruin	Tail Value at Risk (TVaR)
Residual Risk	

# Culture & People

## Getting people to believe in ERM analysis when results contradict preconceived notions or plans



- Develop enough credibility that this is not a problem
- Provide more timely information to limit misconstrued preconceived notions
  - Quarterly ECM reports not timely, e.g. available more than a month after the close
  - Business managers get quite a variety of useful information daily, weekly and monthly
    - ERM needs to monitor risk drivers and KRIs and create a variety of risk reports on weekly and monthly basis
      - Can you append risk information onto most popular existing reports?
      - Preview volume and rate variances that will show up at the end of the quarter
- ERM reports need to provide insights that demonstrate the value of the analysis

## Other Top 10 Ideas

Consider skill sets needed  
for different roles of CRO  
(Culture & People)

Risk Committee members  
to raise risk issues in  
strategy discussions  
(Culture & People)

Develop attitude that  
“good enough” is actually  
good enough and stop  
striving for perfection  
(Process)

ERM prepared for  
discussion of balancing  
risk, capital, returns, &  
growth  
(Objectives & Strategy)

Cross functional risk  
discussions with the  
businesses add  
tremendous value  
(Process)

# Conclusions



- ERM has (or could have) a unique perspective on the business, looking across all functions and aspects of business, providing insights that could, and should, be invaluable to strategic decision-making
- To become more valuable to Strategy *formation*, ERM should realign direction towards
  - People involved in strategy, using the same terms when possible
  - Information that is useful to strategy
- ERM should cease to be a separate silo and strive to become *part of the flow*

## Strategy + ERM



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**Thank You.**



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