Actuarial Risk Management
Global Actuarial Consultancy

Strategies & Risk Solutions for Executives

2022 ERM Practice: Framework

They started to call it Enterprise Risk Management, or ERM, shortly before the turn of the century. But even now, more than 20 years later, we still find that the adoption of ERM is uneven throughout the insurance business. This fall, we heard from over 50 insurers about what they are doing with their ERM practice.

What we found to be interesting is that in a few areas of practice, everyone was on board. While there are other aspects of ERM practice that have a wide diversity of levels of practice. Here is what we learned…

First we asked about several fundamental parts of a basic ERM framework. Those are:

- Risk Identification – process of determining which risks that a company needs to consider managing, and prioritizing the most dangerous.
- Risk Management & Controls – have been a part of insurer practices but ERM brings with it an aspiration to apply them more consistently to all of the significant risks of an insurer.
- Risk Reporting – a key part of a control process is communicating the successes and failures and just the day-to-day progress of risk management.
- Risk Governance – Some risk management decisions and actions will be difficult. For ERM to be successful, top management and the board needs to be behind it.
- Risk Appetite & Tolerance – sits at the top of the ERM program and reflects the company strategy and intentions regarding risk taking.
- Risk Culture – is the part of the business culture that relates to risk and risk management. In particular, we look at how the business staffs its risk management efforts.
- Stress Testing – is a key risk evaluation activity that can be used by any company even without a complex risk model. Even fairly simplistic stress tests can provide actionable information about the risk profile of a company

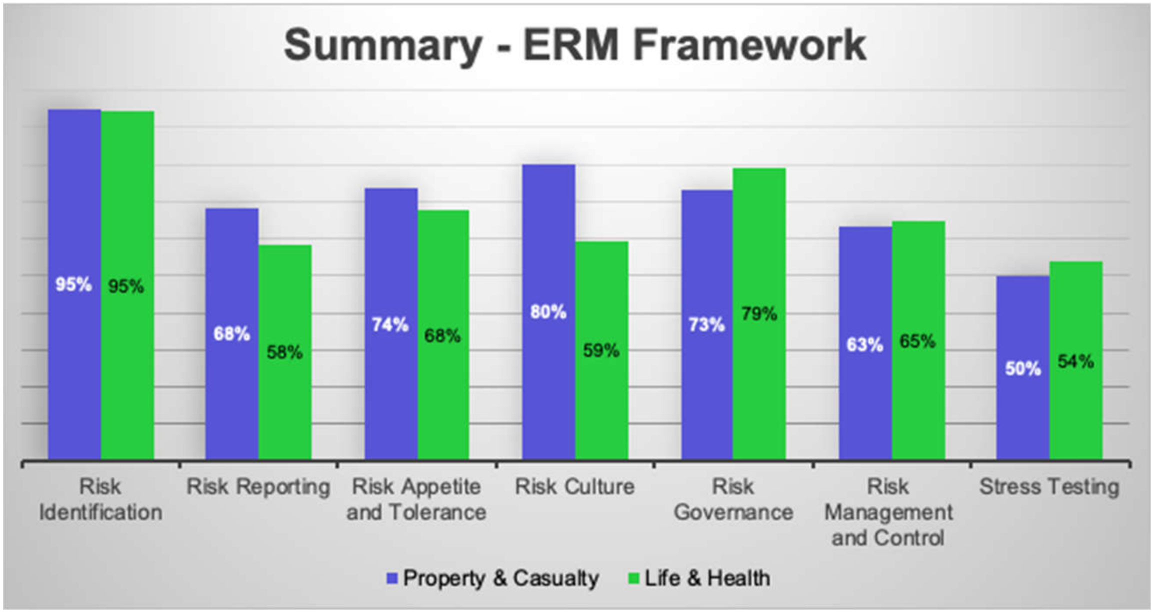
For each of these seven parts of the ERM Framework, we asked insurers to choose among several statements that characterize differing levels of practice. A score of 100% on the following graph would indicate that all companies were following the very best practices for that area.

For Risk Identification, the responses tell us that both Life & Health and Property & Casualty insurers are operating very close to that best practice at 95%. For each of the other six areas, practice is at 80% or lower

Compare your company to the ERM survey results at:
L & H https://www.surveymonkey.com/r/ActRiskSurvey2022
P & C https://www.surveymonkey.com/r/ARMPC2022

+1 512-345-5200 | info@actrisk.com | www.actrisk.com | 5914 West Courtyard Drive, Suite 190. Austin, Texas 78730

Part 1 ERM Framework (cont'd)



"Stress Testing has the lowest scores"

on the average. Stress Testing has the lowest scores with 50% for P&C insurers and 54% for L&H. Overall, 37% of the insurers have Stress Testing scores below 50%.

Practice was below 60% for Life & Health insurers in three of the six areas, Risk Reporting, Risk Culture and Stress Testing. For Property & Casualty insurers only Stress Testing was below 60%.

Overall, there were 25% of the insurers whose scores for Risk Reporting and Risk Management and Control were below 50%. These are two very basic ERM activities that support transparency and active risk management. They are the very next steps that an insurer should be taking after identifying their risks.

In the area of Risk Culture, we saw the largest difference between the practice level of the two sub sectors with practice of the P&C insurers at 80% and L&H insurers 21% lower at 59%. For Risk Reporting, L&H insurers outscored P&C insurers by 10%, 68% to 58%.

When we look at these scores averaged by company, we see that 12% of the companies have an average score under 50%. Slightly over half of the companies (51%) have a score between 50% and 75% and the remaining 37% of companies had average scores over 75%.

NEXT PAGE

+1 512-345-5200 | info@actrisk.com | www.actrisk.com | 5914 West Courtyard Drive, Suite 190. Austin, Texas 78730

2022 ERM Survey: Capabilities

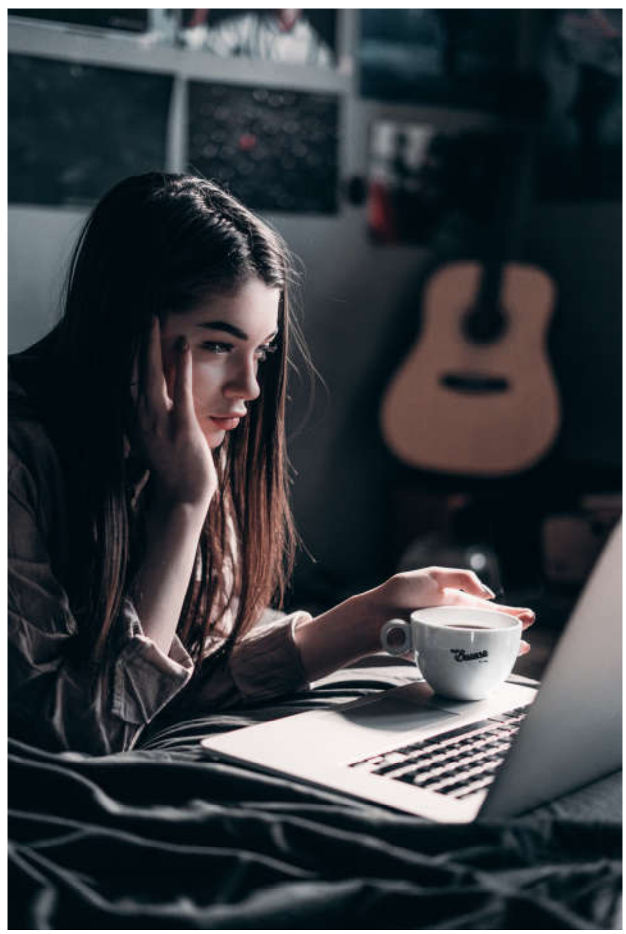
Many say that insurers have always managed risk, and that is addressed in our ERM survey with questions on risk management capabilities.

Each company has a diverse set of capabilities depending on their unique risk exposures. An insurer may have a limited geographic presence or high product complexity so will naturally develop different capabilities.

ERM Capabilities

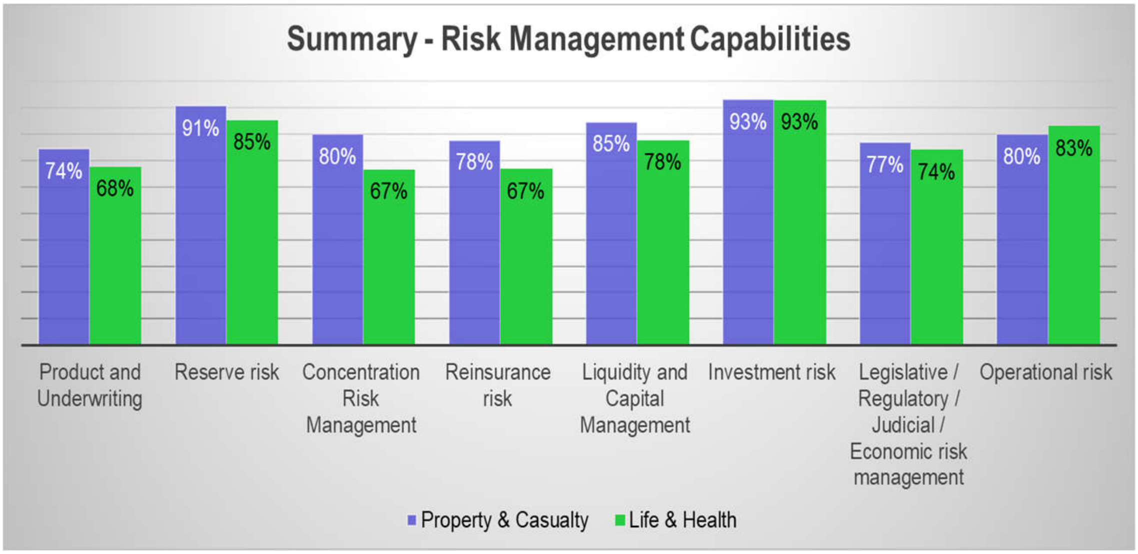
There are eight categories of ERM Capabilities in the survey and companies were asked several questions about each of them. They are:

- Product and Underwriting – considers an insurer's unique risk exposures and how they manage them
- Reserve risk – holding adequate reserves is key to the ongoing success of an insurer. Experience and scenario analysis encourages resiliency.
- Concentration Risk Management - Monitoring and managing all kinds of concentrations, not just product and geography, are important considerations when a company is not diversified.
- Reinsurance risk – due diligence of a reinsurance program considers potential negative outcomes.
- Liquidity and Capital Management - solvency risk typically builds slowly until a liquidity event occurs. Philosophy toward building resiliency using redundant capital, the ability to raise capital and borrow quickly is considered.
- Investment risk – portfolio oversight and participation in familiar asset classes, using metrics to measure default, interest rate, equity and concentration risks
- Legislative/Regulatory/Judicial/Economic risk management – external risk exposures should be identified, monitored and managed.
- Operational risk – manage risks with data including disaster recovery and business continuity using internal controls and external assessments.



NEXT PAGE

Part 2 ERM Capabilities (cont’d)



Similar to the ERM Framework, we asked insurers to share whether capabilities were new or longstanding. A score of 100% on the following graph would indicate that all companies have long standing capabilities for that area.

Insurers already managed specific risks prior to ERM so it’s not surprising that overall results are higher than for an ERM Framework. The lowest Property & Casualty result was for Product and Underwriting, at 74%, while for Life & Health both Concentration Risk Management and Reinsurance risk were 67%. The biggest differences between L&H and P&C insurers were for Reinsurance risk capabilities where P&C outscored L&H by 11% and for Operational Risk capabilities where L&H was 3% higher.

All of the capabilities scored 67% or higher on average. It is important for individual companies to review their own results to see if there is a capability they should improve or plan to communicate why that risk is not a priority.

Reinsurance risk was the category with the highest number of insurers saying it was not yet a capability, at 19% for P&C and 27% for L&H. There are many ways to apply the proportionality principle to reinsurance. For example, some companies focus on distribution so reinsure 100% while other direct writers participate in a group that pools their business. It forms a continuum, so

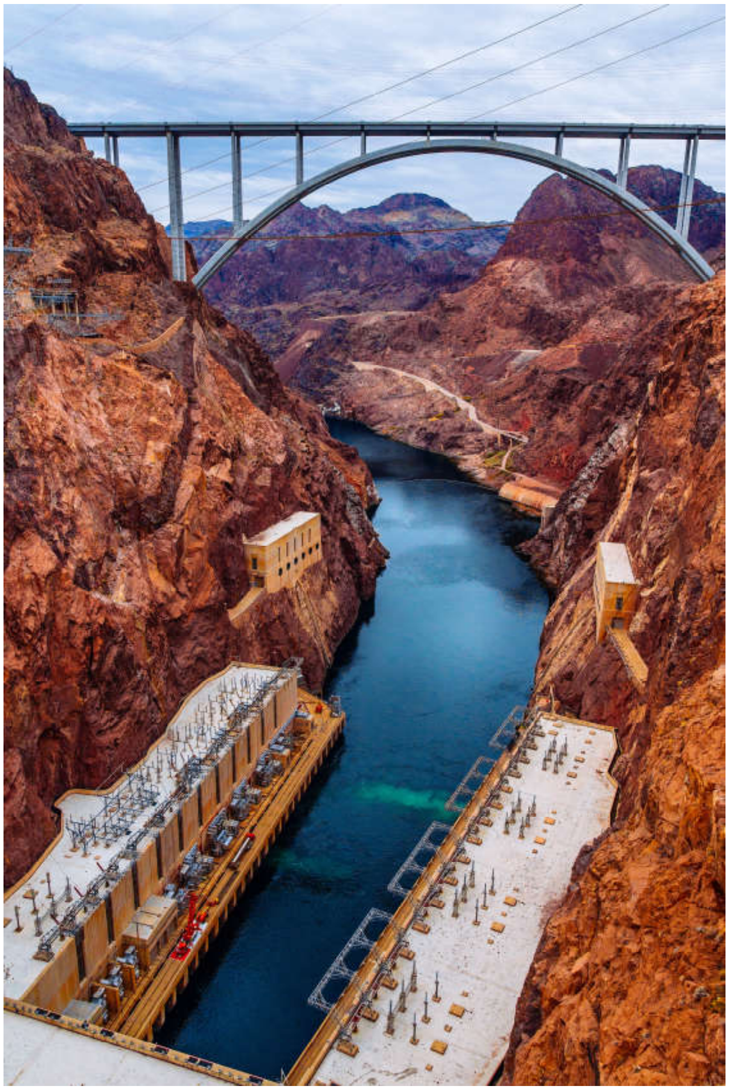
+1 512-345-5200 | info@actrisk.com | www.actrisk.com | 5914 West Courtyard Drive, Suite 190. Austin, Texas 78730

Part 2 ERM Capabilities (cont'd)

companies that right-size their ERM capabilities will want to communicate their thinking if it causes a broad survey to result in an inconsistent outcome.

A few individual questions resulted in surprising answers. Here are some where enough reported not having the capability to make it an interesting follow-up.

- Risk control cycle
- Risk correlation management
- Reinsurance risk capabilities
- Limited reliance on reinsurance
- Line of credit
- Make preparations well in advance of legislative and regulatory changes
- Appropriate participation in lobbying efforts
- Access to reliable, accurate, comprehensive and timely data
- Segregation of duties



The survey shows, for both the ERM Framework and ERM Capabilities, that the current state of the art for insurers is good and continues to improve. Companies need to make sure that they share their good practices with rating agencies so they are credited for their efforts. It can be helpful to seek outside help to ensure terms are understood by external audiences and to seek out shortcomings that could be easily addressed. For example, a company could add a couple of deterministic stress scenarios that highlight a specific financial risk or document an AI-based fraud detection program that has been cost effective.

To view the full ERM Survey report visit the ARM website at https://www.actrisk.com/newsletter-category/quarter-4-2022/

+1 512-345-5200 | info@actrisk.com | www.actrisk.com | 5914 West Courtyard Drive, Suite 190. Austin, Texas 78730

Actual Risk Management

Global Actuarial Consultancy

Strategies & Risk Solutions for Executives

Tiered subscription service advising insurance company executives on risk topics and sharing solutions and mitigation strategies.

Tier 1

Discussion + Webcast + Newsletter

- Adds private one-hour discussion with newsletter authors to Tier 2 webcast and newsletter
- Unlimited seats for $3,000 annually* or $1,000 quarterly

Tier 2

Webcast + Newsletter

- Adds access to one-hour live webcast to Tier 3 newsletter
- Webcast includes brief presentations and interviews with authors
- Unlimited seats for $1,000 annually* or $300 quarterly

Tier 3

Newsletter

- 3 to 6 articles quarterly
- Written by Dave Ingram, Max Rudolph and other ARM consultants focusing on risks faced by insurers and risk management strategies
- Available for no charge on the ARM website

* Annual subscriptions available for individuals at 50% discount

“

While insurers have been challenging by low interest rates and the pandemic, the next few years will see a radically changing environment for insurers. We will be using this provocative platform to identify emerging risks and delve into what we see as the drivers of future success.

DAVID INGRAM | SENIOR ERM CONSULTING ACTUARY

”

Sign-up to receive future newsletters automatically at https://www.surveymonkey.com/r/AMRSRSE

+1 512-345-5200 | info@actrisk.com | www.actrisk.com | 5914 West Courtyard Drive, Suite 190. Austin, Texas 78730