Actuarial Risk Management
Global Actuarial Consultancy

Crossing Thin Ice
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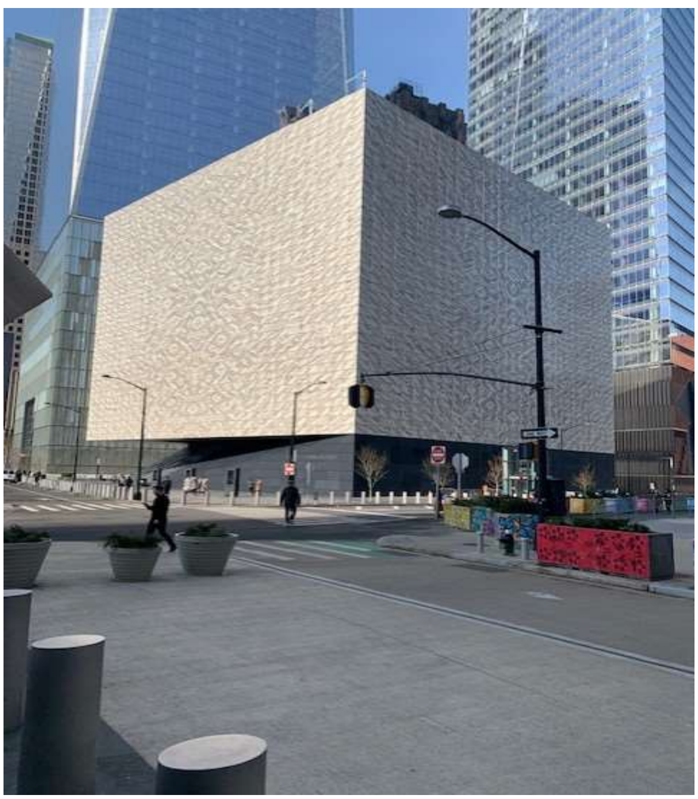

Sign up for our June 12 webcast where we will discuss these articles

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To Our Subscribers

We want to thank our new subscribers and welcome everyone to the tenth issue of the ARM Crossing Thin Ice newsletter! We hope that you find this publication valuable. With a few short articles meant to provide unique and valuable insights, we present ideas about how to address specific issues related to ERM and introduce potential risks and opportunities that may not yet be on your radar.

The primary authors are Dave Ingram and Max Rudolph. We have been active participants in the risk management, actuarial, investment and insurance spaces for many years.

Subscribers are encouraged to suggest topics for articles and ask questions of the authors during our follow-up webinars and podcasts. Ever cognizant of regulatory requirements and leveraging them to add value in practical ways is our focus.

Sponsored by **Actuarial Risk Management (ARM),** Crossing Thin Ice is free to all readers and in all forms.

A free webcast and podcast with the same name are also available. If you would like to further engage the authors as consultants, for continuing education purposes or to join our Risk Management Discussion Group, please reach out. More info can be found throughout this newsletter. We hope to help you find a solution that meets your needs!

Please forward to others who study risk.
For more details
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The content of this newsletter is meant to be educational and thought provoking.

Nothing in it should be interpreted as investment advice.

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Overconfidence

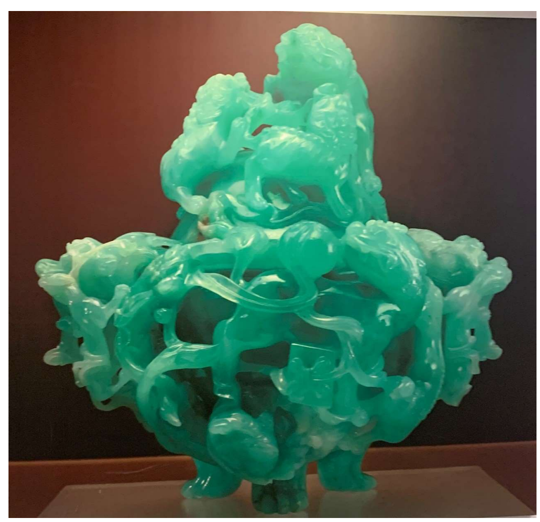
I am really sure that this will be an interesting article, but then, I have always been an Overconfident Writer. In the case of writing, I think that you need to be somewhat Overconfident, or else you would never put words on a page.

There are many realms like writing where overconfidence might be needed to get you off of square one, like public speaking, a new fitness routine or a diet. But there is a lot of danger in overconfidence when you are a senior executive of an insurer. Insurance, where premiums are collected ahead of claims, is a business where overconfidence often occurs and ends up resulting in frequent problems. An overconfident insurance manager might underprice their policies, embark on investment strategies that are much riskier than assumed, fail to adapt to changes in the environment along with a host of additional optimisms. One of the primary jobs of the Chief Risk Officer is to look out for overconfidence and to figure out a way to protect the company from the consequences.

But Overconfidence can also afflict the CRO. The job of CRO in an insurer requires an incredibly wide range of skills and experiences, including quantitative analysis, strategic thinking, communications, leadership, influencing and change management in addition to the specific knowledge of risk management, regulatory and rating agency requirements and comprehensive knowledge of every activity within the insurer. Someone who is successful at the CRO job probably needs the services of an ancient Roman "memento mori" who reminded the General celebrating a Triumph with a parade through Rome that they were still mortal.

The temptations of overconfidence for the CRO all boil down to the same thing - giving too much weight to their own opinions than to emerging real world experience. Examples include:

- Delayed recognition of Emerging Risks - Nassim Taleb gave the name "Black Swan" to the type of emerging risks that are not recognized in advance but have a high negative potential and are retroactively declared to have been predictable. Events like the 2008 Financial Crisis and the 2020 COVID pandemic fall into this category.



Ask Dave and Max about their quarterly Risk Management Discussion Group

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Overconfidence (cont'd)

- Over Reliance on Complicated models - The output of complicated risk models are often presented as facts, as a way of developing the willingness to make decisions using those outputs. But in actuality, conclusions from these models fundamentally flow from decisions made by the modelers about the relationship between the past experience and the possible futures. If the CRO has been the final arbiter in decisions regarding model assumptions they are likely to be personally invested in those decisions and reluctant to make changes. They know that the model loses credibility with many audiences if the findings change too much or too frequently. So the CRO might overconfidently over-rely on the models.
- Disregarding Input from the Trenches - The executives of some insurers spend too much of their time talking with each other and not enough time talking to the people who are personally experiencing the business environment. Often new trends, both good and bad, are first felt at the fringe of the organization's reach, by sales people who are talking to customers and by customer service staff who are handling questions. But the CRO, who has no natural connections to either of those two sets of people in the trenches, may become overconfident with using the information that they receive via their risk reports.
- Overpromising on Risk Mitigations - When there is a new product at an insurer, a really good CRO will be at work during the product development phase, working with the product development team to identify any new mitigation programs that are needed. The CRO is likely aware that none of the existing risk mitigation programs are executed perfectly, but the temptation with a new mitigation is to initially evaluate it as if execution were perfect. In reality, sometimes mitigation actions are taken late, or they might not be the exact actions that were intended. Usually, effectiveness of mitigations is measured in terms of actual execution rather than ideal execution. But the CRO can behave overconfidently and assume that the mitigations that they design for the new product will happen exactly as planned.

Check out the Crossing Thin Ice podcast

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Overconfidence (cont'd)

To overcome these and other types of Overconfidence that the CRO may fall prey to, they need to do one or several of the following:

Stress Testing and Scenario Analysis - We recommend this on almost all occasions and this is one where it is particularly applicable. The CRO should be using these tests personally to assess what could be different if they are wrong about any of their positions about risks. This approach is particularly well suited for assessing the impact of Emerging Risks and of looking at alternatives to the complex model. What if we are wrong is the question that a Stress Scenario answers.

Diverse Inside Perspectives - If the CRO is in a larger organization, they will likely have a team of folks supporting them. To help the CRO deal with overconfidence, it is important that this team includes a couple of people who tend to have a different point of view and to encourage them to speak their mind. Linking this idea with Stress Testing, it would be a good idea to have some of the stress test scenarios represent those alternate viewpoints, which will make them a good test of Overconfidence. In a smaller company, the CRO will need to get these perspectives from interactions with other company leaders.

Outside Perspectives - As mentioned above, the CRO role does not include any natural links to company people at the edge of company activities. So to protect against overconfidence, the CRO needs to deliberately seek out outside perspectives by attending conferences, joining local, regional or national groups of executives where even casual conversations will provide a window on the world outside the company. Formal feedback from independent reviews of the risk management program can also offer the needed outside perspective.

It may seem ironic that the CRO, who is responsible to look out for overconfidence in the rest of the company, needs to look out for their own overconfidence, but if they are following some of the above suggestions or other ideas, they can be even more effective in helping to root out and overcome other's Overconfidence.

And lastly, the CRO needs to find their own 'memento mori' who brings them back down to earth. For me it has always been a brother who has never been even slightly impressed by me. It is important that I stay in touch with him. Too long apart and I start getting too impressed by myself.

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Crossing Thin Ice

Now providing three ways for you to get insights, strategies and solutions from ARM consultants to help resolve your risk issues.

Newsletter

- 3 to 5 articles quarterly
- Written by Dave Ingram, Max Rudolph and other ARM consultants focusing on risks faced by insurers and risk management strategies
- Available on the ARM website

Webcast

- One-hour live webcast once each quarter following the newsletter publication
- Webcast includes brief presentations, interviews with authors and live Q&A with your questions answered regarding the newsletter topics

Podcasts

- Two per month
- Delivered by Dave Ingram & Max Rudolph
- Presenting material from the newsletters, webcasts and current topics in a totally audio format.
- Available wherever you download podcasts

* No charge for subscriptions to any of the three services

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Insurers have faced challenges from inflation, high interest rates, high turnover and shrinking candidate pool, and the next few years will see a radically changing environment for insurers. We will be using the Crossing Thin Ice platform to identify emerging risks and delve into what we see as the drivers of future success.

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