Actuarial Risk Management
Global Actuarial Consultancy

Crossing Thin Ice
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Contents

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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.
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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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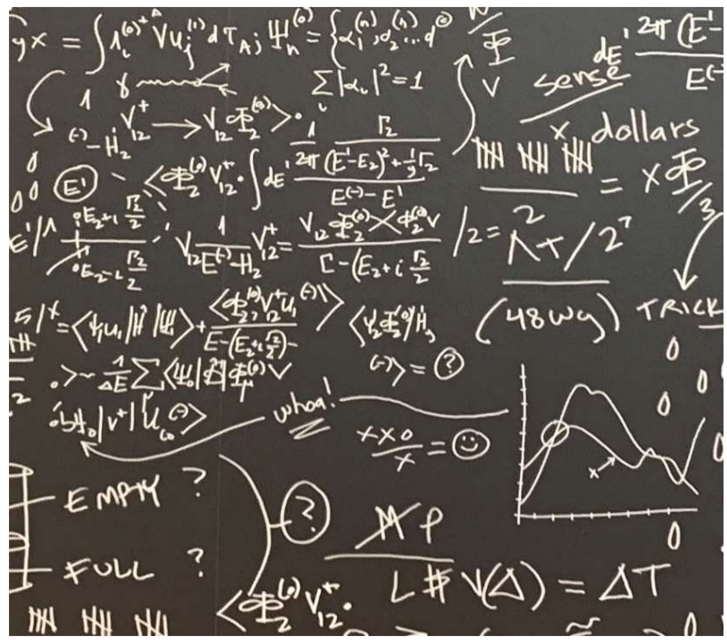
Scenario Planning in 10 Steps

Many companies have used Scenario Planning as a major part of their strategic planning process, indeed Strategic Scenario Planning by Royal Dutch Shell was what first made the practice famous. We have talked a lot about Scenarios. Today we want to introduce you to a 10-step process for using Scenarios to inform your planning process.



Step 1 - Purpose and Scope of the Scenario Planning Exercise

Scenario Planning is used to do a deep dive into how company strategy might have to change in different future environments. But Scenario Planning can also be used with Risk Management to look at Emerging Risks, for crisis preparation and for any other forward-looking activities within a company. A Scenario Planning exercise can either be charged with identifying different arenas for their investigation or they may be convened with a charge to look at a specific individual predetermined change.

Step 2 - Assemble a Team for the Scenario Planning

You always want this done by a group and you always want that group to be as diverse, in terms of viewpoint and experiences, as possible. The whole point of scenario planning is to get people thinking about something that hasn't happened but that could happen. You do want someone there who is an expert on doing things the way we have always done them so that the process doesn't go totally off the rails looking at solutions that are impossible to execute, but you are looking for mostly or even totally new responses. Most often the thinking of people who are not totally in the weeds can spark ideas about new solutions. Specific roles of the participants on the team should include Leader/Facilitator, Subject matter experts, stakeholder and risk manager. Someone needs to be responsible for documenting and communicating the process and finally, the folks whose role is to provide the variety of perspectives.

Step 3 - Identify Potential Drivers of Change

Going back to the last element of the scope discussion

Scenario Planning in 10 Steps (cont'd)

above, if the Scenario Planning Exercise is targeted to a particular change, then the group will need to work backwards and determine the drivers of that change. If asked to identify major change scenarios, then this task becomes identifying the drivers of change that might lead to some situation that has a major impact on the business of the company. These drivers could be economic, technological, political, environmental, demographic, competitive or other factors.

Step 4 - Develop Scenarios

I have often started a scenario development process by defining two or three different degrees of change for each of the Potential Drivers. Then I look at the possible combinations of those situations. For example, I was looking at Level of Debt, Climate Change, Demographic Changes and Technological Developments as four drivers. Then I looked at three levels of change for each. Things get better, stay the same or get worse for Debt and Demography. Things stay the same, get worse or get much worse for Climate. Slow development, moderate development, and rapid development for Technology. There are 81 combinations. From those combinations, I would then pick 8 - 10 different combinations and look to choose three or four for the planning exercise. I often use the idea that I have described previously of looking at three levels of likelihood in making my choices - normal volatility, realistic disaster and worst-case scenarios. Care should be taken to involve all of the diverse voices from the team in the process of envisioning and choosing the scenarios to work with.

Step 5 - Analyze Impact

With a short list of scenarios in hand, the group would now proceed to analyze the potential impact of each scenario. If this exercise is for an insurance company, the impact on Growth, Profits, Assets, Claims, Reserves, expenses, and overall employment would be assessed by the team. It is good to have some scenarios that result in little trouble to the company, some that might disrupt earnings significantly and some that might threaten the adequacy of capital. Disruption of plans in other ways should be considered as well.

Step 6 - Identify Early Warning Signals

While the team has their heads under the hood, looking at the details of the scenarios, it is helpful to think about the signals that could be a warning sign that a major problem is on its way. This is why the three levels of likelihood are helpful. They can be used to identify these early warning signals. The scenarios are all imaginary right now, but we will need to know when one might be becoming real so that we can prepare.

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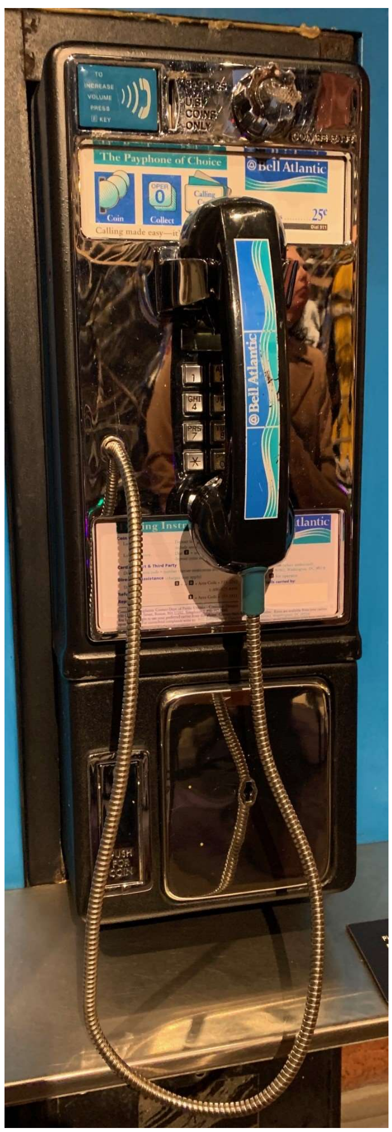
Scenario Planning in 10 Steps (cont'd)

Step 7 - Develop Strategies

For the scenarios that show significant adversity for the company, the team will develop potential strategy shifts that would reduce the adverse impact of the scenario. That might involve small modifications to existing strategies, or it could require stopping one or more of the main strategies either temporarily or permanently or adopting a new approach to risk mitigation.

Step 8 - Stress Test the Strategies

For each scenario where an alternate strategy is wanted, the potential strategies need to be assessed, looking at the same factors that led to the concerns about the scenario in the first place. If strategies fail to resolve the concerns, then go back to the drawing board to look for alternate strategies that try different changes to company strategies and risk mitigations or at least more of the same changes.



Step 9 - Communicate the Findings

Communication of the findings of a scenario planning process must get the audience to understand the concerns raised from the scenarios and the importance of the strategies that are found to alleviate the issues from the scenarios without making them listen to a blow-by-blow description of the entire process. The findings of the process need to be simplified down to a few short insights. The stories of the scenarios and the reasons why the company needs to pay attention to those scenarios should be told. Finally, the suggestions of the triggers that the company should be on the lookout for, along with any other suggestions of any other sorts of readiness that is needed.

Step 10 - Implementation Guide

Finally, if in the planning process the company decides to accept the recommendations of the Scenario Planning Team and to incorporate the idea of readiness for one or several of the scenarios that were studied, the team needs to prepare a preliminary Implementation Guide for the alternate strategies to include detailed instructions on how to put those changes to strategies or new strategies and mitigations in place. It is recognized that it is highly unlikely that whatever happens will not match up exactly with any of the studied scenarios, so these implementation plans should also indicate likely places where they will need to be modified to reflect the actual situation on the ground.

This is a quick summary of the steps to a Scenario Planning process.

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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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