



SOCIETY OF ACTUARIES

**ERM Symposium
April 2009**

**D1-How are Companies Adding Value via ERM?
Details on Recent Global Insurance Industry
ERM Studies**

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Judy Wong**

How Are Companies Adding Value from ERM?

Findings from the Fifth Biennial Global ERM Survey Embedding ERM — A Tough Nut to Crack

Linda Chase-Jenkins

April 2009



Towers Perrin conducted a Web-based survey in 2008 among senior executives in major insurance companies around the world

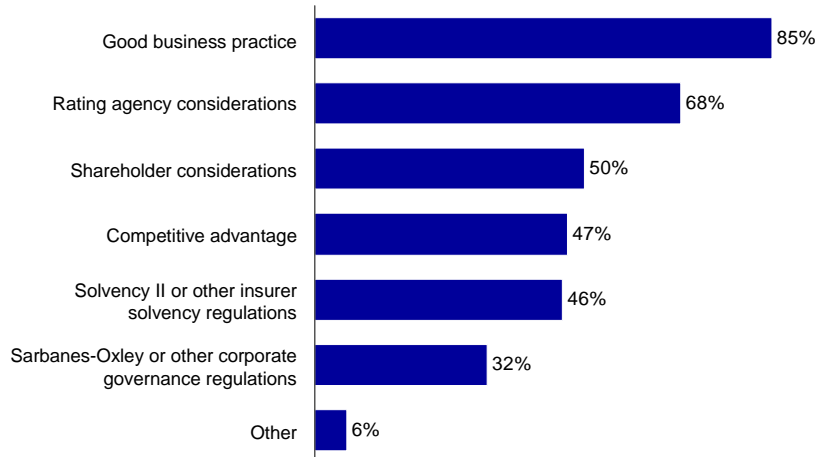
- Chief Financial Officers, Chief Actuaries and Chief Risk Officers were asked to document the approaches to, and current status of, ERM activity within their companies
- A total of 359 executives responded, making this the largest global survey of the insurance industry on its topic
- Respondents include a wide range of insurance organizations from North America (49%), Europe (29%), Asia/Pacific (19%), Latin America (2%) and Africa/Middle East (1%)
- Respondents come from all lines of business, including life insurance (34%), P/C insurance (33%), reinsurance (20%) and multiline insurers (13%)

There were six key findings

1. Embedding ERM is proving to be a significant challenge
2. Size matters
3. European insurers are better placed
4. ERM is influencing decisions
5. Economic capital standards are emerging
6. Operational risk remains a weak spot

ERM Drivers and Challenges

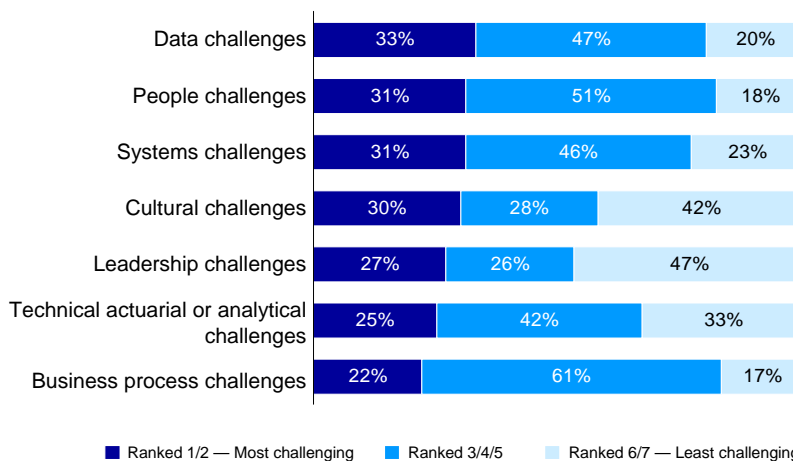
Good business practice is the key driver of risk management, and competitive advantage is also a key driver of ERM



Base: Total Respondents for Q.1 What are the key drivers of your current risk management efforts? Please select all that apply.

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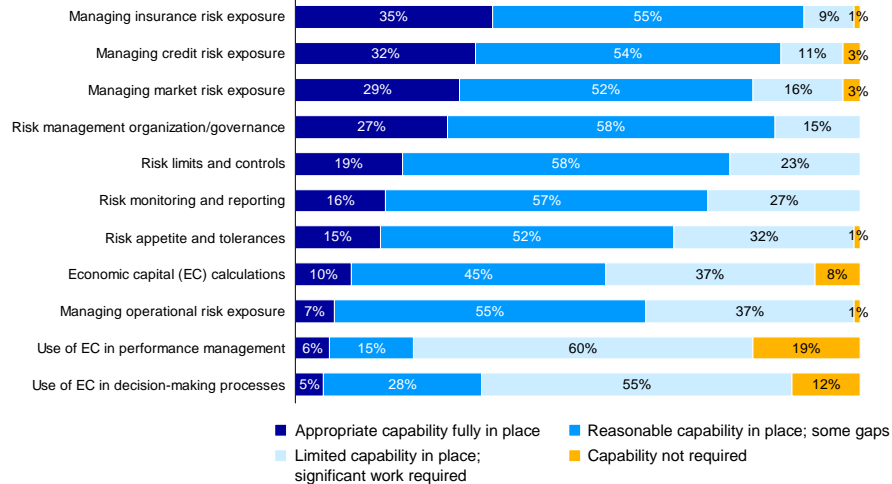
Data, people and systems were highlighted as the top three challenges in implementing ERM and realizing value



Base: Total Respondents for Q.2 To what extent do the following areas present challenges in implementing ERM? Please rank these options where 1 is most challenging and 7 is least challenging.

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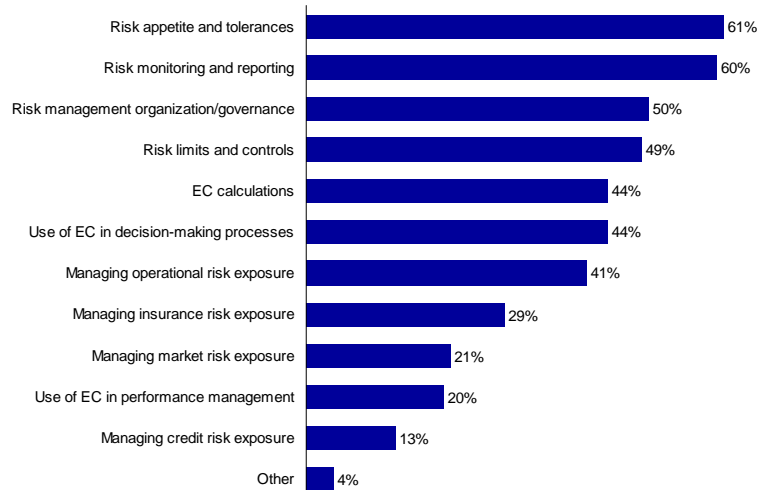
Significant work is required toward activities that can help create value



Base: Total Respondents for Q.3 How would you assess your current risk management capabilities in each of the following areas? Please select one level of capability for each area.

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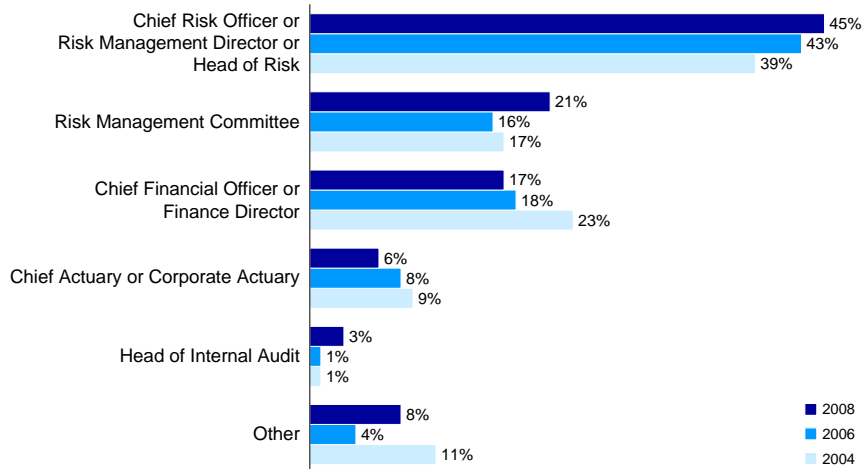
Making effective use of ERM and EC is not being accorded as high a priority



Base: Total Respondents for Q.4 What are your ERM priorities for 2008/2009? Please select up to five items.

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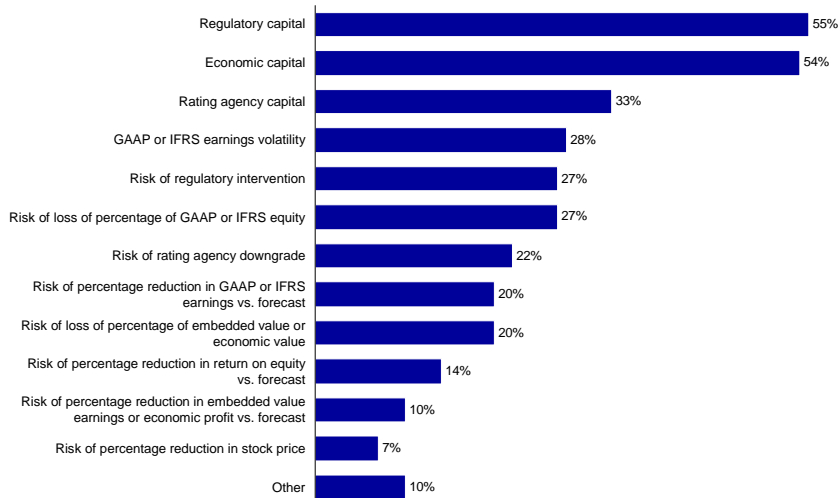
The shift in responsibility for risk management from CFO/Chief Actuary to CRO/Risk Management Committee is slowing



Base: Total Respondents for Q.7 Who, below the Board of Directors, is primarily responsible for risk management in your organization? Please select one response.

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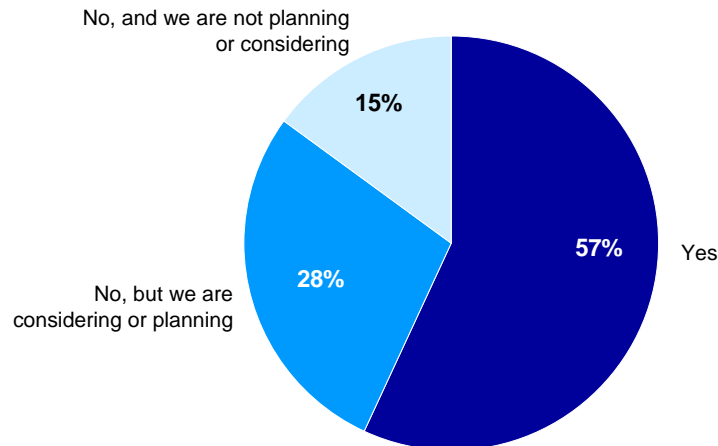
Balance sheet solvency is the principal focus of risk appetite/tolerance statements



Base: Those that have a documented risk appetite/tolerance statement **n=168** for Q.12 Which of the following measures of risk are used in your risk appetite/tolerance statement? Please select all that apply.

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The proportion of respondents calculating EC has changed relatively little since our 2006 survey



Base: Total Respondents for Q.16 Does your organization calculate economic capital (EC) (i.e., a measure of the amount of capital needed based on the risks in the business)? Please select one response.

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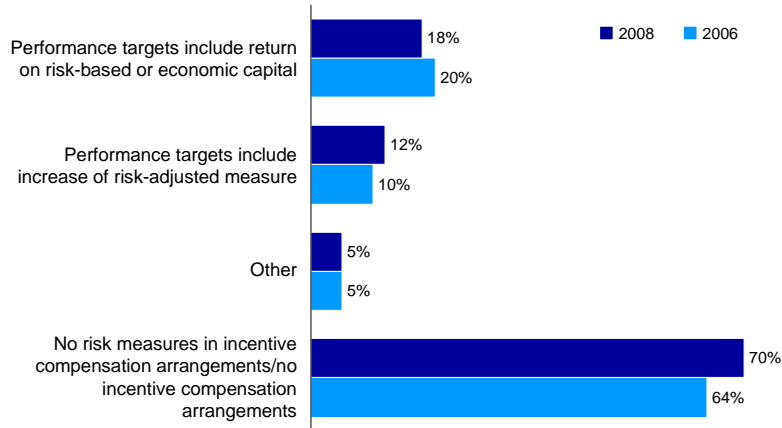
Utilization of EC in decision making is set to change dramatically over the next two years

- Use of EC in performance measurement is relatively low among all insurers. However, 84% of larger insurers plan to address this in the next 24 months
- Among all insurers, 66% have no plans to use EC within incentive compensation plans; this reduces to 37% for larger insurers
- Current and planned utilization is generally significantly higher:
 - In larger companies than in smaller companies
 - In Europe than in North America and Asia/Pacific
- For many aspects, 30 – 40% of smaller companies globally and of all companies in North America have no plans to use EC

Base: Total Respondents for Q.23 Do you currently use or plan to use Economic Capital in decision making for the following areas? Please select one response for each area.

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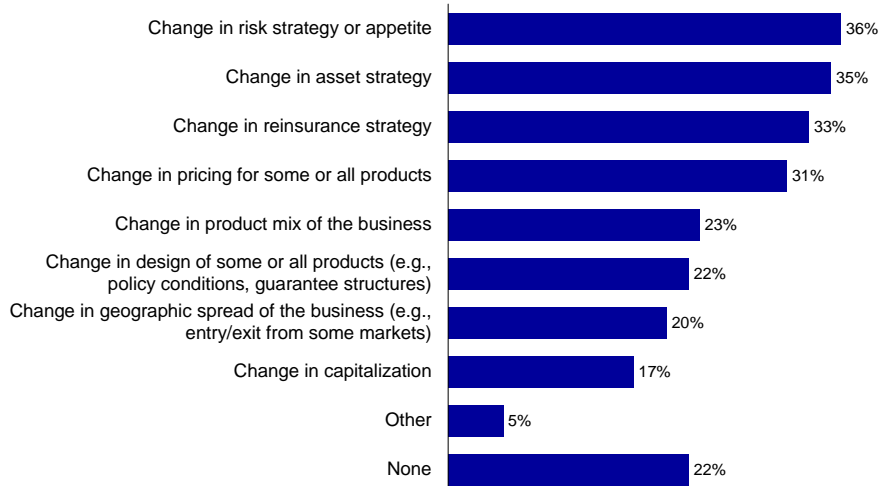
Only 30% of respondents indicate that risk measures are included in incentive compensation arrangements



Base: Total Respondents for Q.24 How are risk measures incorporated into your organization's incentive compensation arrangements? Please select all that apply.

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For almost 80% of respondents, key business changes have resulted from their ERM activities in the past two years



Base: Total Respondents for Q.25 Over the past two years, what key business changes have resulted from your ERM program? Please select all that apply.

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How are Companies Adding Value through ERM? A Look at the PwC 2008 ERM Survey Results

ERM Symposium
April 30, 2009



Agenda

- Overview of the PwC 2008 ERM Survey of the Insurance Industry
- ERM successes to date
- Remaining challenges and next steps for the industry



Background to the PwC 2008 ERM Survey of the Insurance Industry

- Updates our 2004 survey
- Over 1000 questions across 11 sections
- Measures the progress of companies along the road to ERM maturity and outlines challenges
- Respondents:
 - 53 global insurers and reinsurers, of which 29 North American
 - Coverage of the various industry segments: 45% Life & Health, 23% P&C, 21% Composite, 11% Reinsurers
 - Predominantly CROs or others responsible for overseeing ERM

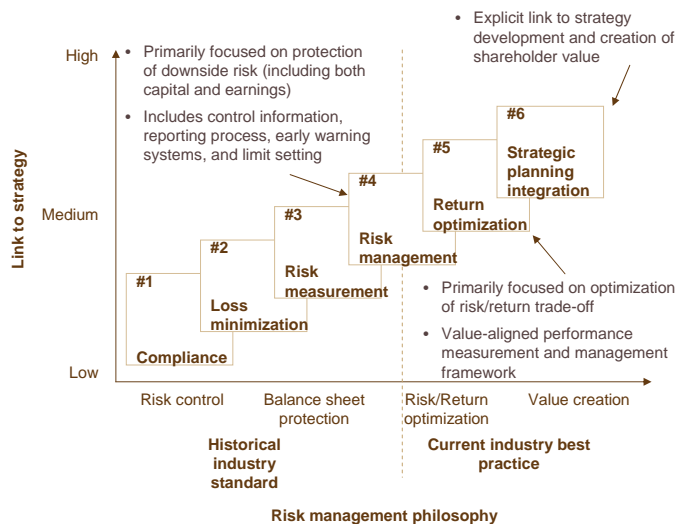


Summary of key survey findings

- 1 ERM has made significant inroads at the top
- 2 The bar for ERM is rising
- 3 Governance over ERM is still an issue for many
- 4 ERM is not yet well integrated into the business
- 5 Risk data and modelling is still a problem
- 6 Alignment of risk and finance is still limited
- 7 Solvency II and MCEV are heightening the stakes for North American organizations to keep pace
- 8 The industry recognizes need for further development



Evolution in strategy and risk management philosophy



Agenda

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The current environment has called for a strengthened focus on risk management principles

- New products that present complex combinations of equity market and interest rate risk, as well as business & operating risks
- Globalization of businesses
- Increased focus on efficient capital structure
- Emphasis on “no surprises” in financial results
- Better modeling tools and new frameworks for measuring risk
- Movement from historic risk management practices to newer risk management concepts and processes
- Recognized need for well integrated, enterprise wide oversight structures for risk management

ERM is making inroads

- Established ERM programs and structures
 - More than 90% of insurers have ERM programs in place and ERM is a Board priority across the industry
 - Chief risk officers are gaining in stature: In about 60% of firms, the CRO communicates directly with the board on at least some risk management issues
- Reporting risk information to the Board and senior management has improved
 - Risk dashboards are increasingly used, now by 40% of respondents
 - Risk reporting is given the highest priority with respect to IT development by most respondents
- Around three-quarters of respondents discuss their economic capital program with rating agencies (up from some 50% in 2003) with approximately 35% and 50% disclosing them to analysts and investors respectively
 - The percentage of respondents disclosing their results to rating agencies is significantly higher in the US (over 90%), whereas disclosure to analysts and investors is more common in Europe (50% and 67% respectively)

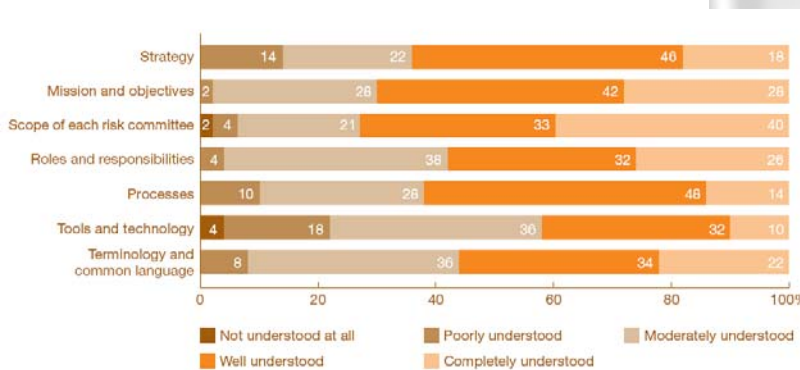
Areas of progress since last ERM Survey

- Strong progress:
 - Most respondents are at least fairly confident (44% very confident) that they have clearly defined their risk appetite, yet alignment of risk appetite and key business decisions remains limited.
 - Nearly 80% of respondents have a scenario- and model-building capability, compared to only around a half in 2004.
 - Growing influence of chief risk officer and clear trend towards Board-level ERM committee.

- Some progress:
 - Most ERM functions have at least begun to set firm-wide standards for risk management, compared to less than 50% in 2004.
 - ERM is getting embedded into strategic planning (42% are very confident compared to 4% in 2004), although risk information, communication and organization remain less than adequate.
 - ERM programs are seen to enable communication of a portfolio view of risk to senior management (50% compared to 36% in 2004) although some of the necessary risk aggregation is still patchy.
 - Nearly 40% report achieving and most others expect to achieve better allocation of capital as a result of developing EC modeling.
 - Nearly 70% have a process for identifying emerging risks, but only around a half of them are even fairly confident that it is working effectively (4% are fully confident).



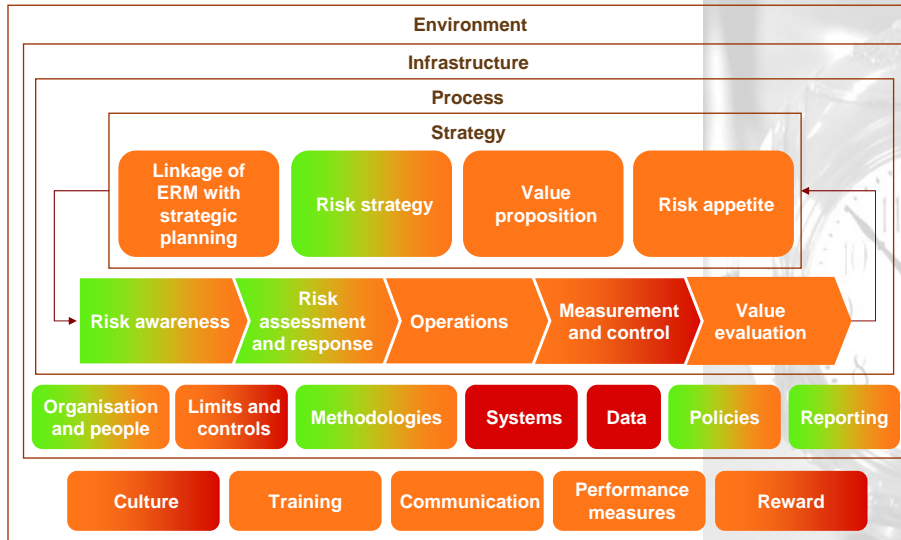
How well are the key elements of ERM understood?



Source: PricewaterhouseCoopers Global ERM Survey



How good are insurers at ERM?



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Governance over ERM

- Many companies are still grappling with the challenges of developing effective ERM governance
 - Around 40% of survey respondents currently have a board-level ERM committee and a further third are considering its establishment
 - The CRO position is relatively new to many organizations (being established within the past two years for 45% of respondents)
- Roles and responsibilities are often unclear and interaction between risk and business units is often limited
 - Less than 40% of survey participants report that the ERM unit is responsible for setting firm-wide standards for risk management and that the practice is operating effectively

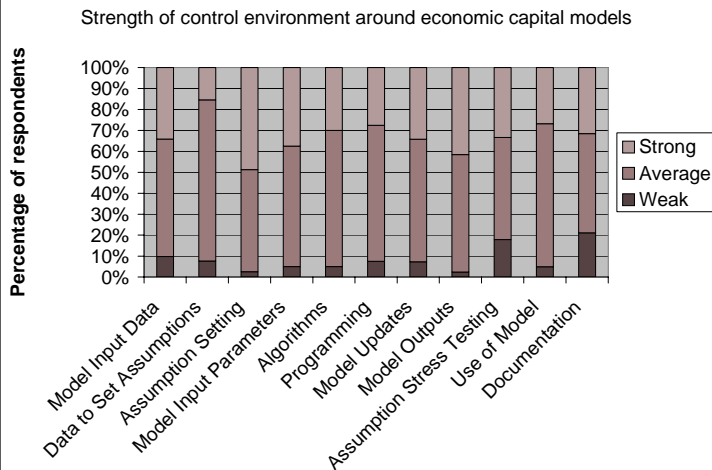
Developing a consistent risk language and aligning risk and finance

- Training is key for 'common risk language'
 - Fewer than 20% say their firm has established an effective risk management training program
- Alignment of risk and financial metrics is limited at best
 - Barely a quarter of respondents strongly agree that they have an efficient basis to link risk with other financial information
- Synergies between IFRS, Solvency II and EC models can act as a catalyst for further alignment
 - Respondents identified an integrated reporting structure, data systems and modeling capabilities as the key synergies they are seeking to pursue...
 - Although most are still at the beginning stages of achieving them
- "Market consistent" concepts being developed in Europe may provide better linkage between risk/capital measures, financial reporting, and valuation
 - Solvency II
 - Economic capital and MCEV concepts
 - IFRS (perhaps)

Embedding risk appetite

- Many organizations are still struggling with the establishment and implementation of risk limits to help map risk appetite into frontline operational activities
 - Only 15% deem risk limits and boundaries to be defined
 - Only 50% of respondents are confident about their ability to define their risk appetite using surplus/risk of ruin
- Many companies do not have solid procedures for limit monitoring and exception approval
 - Nearly 70% of participants accept that their procedures for enforcement of limit thresholds are not operating effectively
 - Only around a quarter of participants have early warning systems to detect when volumes are approaching the maximum threshold
 - Less than 40% processes for identifying and analyzing why limits are breached

Usage and acceptance of economic capital



Risk data and modelling

- The effectiveness of ERM is still often inhibited by the poor quality and reliability of risk information
 - Less than 40% of respondents believe that their risk data are good or excellent
 - Confidence in the quality of data used in catastrophe, economic capital and operational risk models is less marked
 - Lack of confidence in model outputs: 75% do not believe economic capital allocation has gained full acceptance with the business units
 - Timeliness was seen as the most significant data management problem
- While there has been a convergence in the approach to measuring economic capital, many organizations still struggle with elements of their risk modeling (including operational risk quantification, the allowance for diversification, and the difficulties in producing results on a timely basis)

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Integrating ERM within the business

- ERM is often still seen as a reactive and defensive discipline that is only intended to protect the business from downside risk rather than also help manage strategic opportunities and upside exposures
 - Limited link to strategy: Around 70% of participants admit that an effective assessment of risk and controls is not integrated into their strategic planning process
 - 75% indicated that business units do not base their risk tolerances on the broad risk appetite and tolerance levels set by management
 - Some 40% of respondents do not align their risk appetite with changes in strategic direction
 - Half do not align it with the development of new products
 - Less than half report strong collaboration between risk and business teams
- Many organizations are yet to effectively integrate management remuneration with performance measured on a risk-adjusted basis

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Thank you

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