



SOCIETY OF ACTUARIES

**ERM Symposium
April 2010**

**GS2: Chief Risk Officers – ERM Challenges,
Successes, Communication and Evolution in the
Wake of the Financial Crisis**

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**Moderator
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ENTERPRISE RISK MANAGEMENT
ERM
Symposium
Where Cutting Edge Theory Meets State of the Art Practice

General Session

April 14, 2010

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➔ *Financial crisis has highlighted opportunities to strengthen risk management practices in a broad range of areas*

My remarks will focus on 4 of these areas

- *risk appetite articulation and alignment*
- *stress testing practices*
- *management of financial models risk*
- *Corporate Governance - Role of the Board*

Risk Appetite

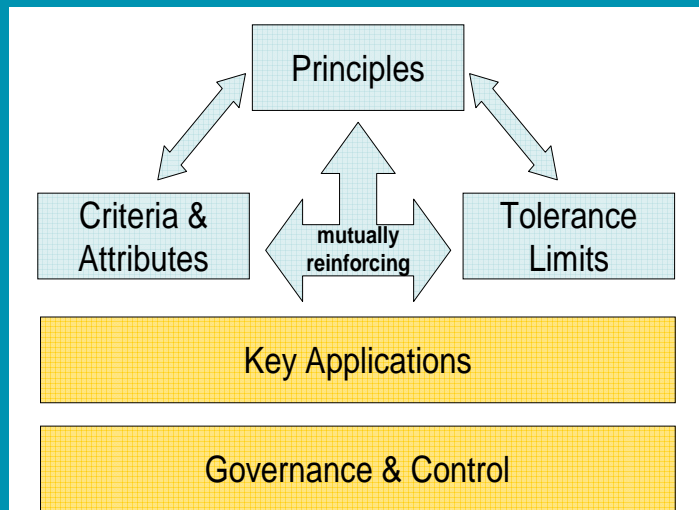


The quantity and nature of risk an organization is willing to assume in pursuit of its vision, mission and business objectives.

**Senior Supervisors Group
October, 2009 report on Risk Management Lessons
from the Global Banking Crisis of 2008:**

“Risk appetite statements are generally not sufficiently robust”

Risk Appetite Statements A Proposed Framework



Risk Appetite

Key Areas of Focus



What Counts (Up) There Must Count (in) Here

- Formal & robust articulation
- Alignment with business strategy
- Board involvement
- Active monitoring
- Fully integrate into management decision making and planning processes
- Incentive system alignment

Stress Testing



What Counts (Up) There Must Count (in) Here

**Basel Committee on Banking Supervision
May 2009:**

“The current crisis underscores the importance of stress testing as an essential risk management and capital planning tool”

Stress & Scenario Testing

Key Areas of Focus



What Counts (Up) There Must Show (Up) In Practice

- Explicit linkage to risk appetite framework
- Process should inform and drive timely management action at both tactical and strategic levels
- Active Board and management engagement
- Holistic approach, recognizing key interactions
- Robust governance and control environment
- Avoid potential pitfalls that can arise from an undue reliance on historical precedent and a “*lack of imagination*”
- Increasing regulatory requirements

Financial Model Risk



What Counts (Up) There Must Show (Up) In Practice

“Those institutions faring better during the recent turmoil placed relatively more emphasis on validation, independent review, and other controls for models and similar quantitative techniques. They also continually refined their models and applied a healthy dose of skepticism to model output”

-Ben Bernanke, 2008

“All models are wrong. Some are useful”

-George Box

Financial Model Risk

Key Areas of Focus



What Counts Up? There Must Be a Bottom

- Implement formal governance and control protocols
 - risk assessment, independent validation, change management, documentation standards etc.
- Stress testing of key assumptions
- Understand and communicate risks and limitations
- Be wary of failure of imagination and inability to acknowledge “*unknown unknowns*”
- Just one perspective ... needs to be combined with qualitative judgment and “common sense”

Role of the Board

Key Areas of Focus



What Counts Up? There Must Be a Bottom

- Move towards the establishment of dedicated Risk Committees of the Board
- Setting and monitoring adherence to formal risk appetite
- Board composition
- Education and training
- Governance of compensation systems
- CRO access to the Board
- “Tone from the Top”

Questions?