Actuary of the Future

November 2011 – Issue 31

Exploring The ABCs of ERM

By Efrem L. Epstein

In recent years, Enterprise Risk Management (ERM) has been one of the hottest topics of discussion within the actuarial profession. On May 18, 2011, the Actuarial Society of New York (ASNY) presented a seminar which highlighted current challenges and navigated potential solutions for life insurance companies seeking to integrate and maintain an effective ERM strategy.

Sim Segal, president of SimErgy Consulting, author of *Corporate Value of Enterprise Risk Management: The Next Step in Business Management* (recently adopted as required reading on the CERA syllabus) and a current VP of the Society of Actuaries, led off the seminar by offering his list of 10 key criteria for benchmarking an ERM program.

First, ERM programs must cover the scope of the entire enterprise, a characteristic that many programs surprisingly lack. Second, they must include all risk categories including operational and strategic risks. Segal noted that many ERM programs focus too heavily on financial and insurance risks, but industry research indicates that strategic and operational risks account for the bulk of firm volatility. Third, ERM programs should highlight the key risks: the top 20-30 threats. Fourth, it is critical to examine the integrated impact of two or more risks occurring simultaneously, since "combination punches" are often the most dangerous. Fifth, ERM metrics, such as enterprise risk exposure and risk appetite, should be aggregated to the enterprise level.

Too often the key findings of ERM are used only to identify and report, so Segal's sixth criterion is that ERM must be used for decision-making purposes. His seventh criterion is to include upside volatility, which is needed for risk-return management. Eighth, is to disclose all risks properly; Segal noted that improperly disclosed risks is the most overlooked risk in and of itself. Ninth, measure the impact of risk on company value. Segal's final criterion is to focus on the primary stakeholder, which for public companies is the shareholder, as opposed to rating agencies.

Damon Levine, vice president of ERM at Assurant, opened his presentation by citing the story of Aron Ralston, recently portrayed by James Franco in *127 Hours*. Mr. Levine noted that Ralston was a chronic adventure-seeker who had nearly died on at least three other occasions prior to his now legendary escape from being trapped under a boulder.

Similarly, companies should be aware that their own patterns of "near-misses" may suggest a higher than perceived likelihood of a true disaster unfolding and they shouldn't feign surprise when they are greeted by their next unplanned crisis.

Still, Mr. Levine suggested that companies should focus on an ERM program that breeds a risk-aware as opposed to a risk-averse culture. Emphasizing that "a good model will tell you things you didn't tell it to tell to you," he highlighted the need for companies to craft customized, consistent ERM models that balance simplicity and capability while taking into account the aggregate of risks. In addition, Mr. Levine noted that it is critical to build and

Efrem Epstein is a career changer who has passed all of the preliminary exams and now serves on ASNY's Continuing Education Committee. He was a presenter at The 2010 SOA Annual Meeting and his writings have appeared in Entrepreneur Magazine and The New York Post. You can reach him at efepst@hotmail.com

maintain a corporate environment where risk managers can be intellectually honest in their assessments and can comfortably report the realistic upside and downside scenarios of every deal, transaction and opportunity.

The final presentation of the afternoon was courtesy of David Ingram, executive vice president of Willis RE and a member of the Actuarial Standards Board ERM Task Force which had recently released discussion drafts of standards for comments and feedback. Mr. Ingram opened by noting the significance of the task force, since standards mark the true sign of a profession's arrival. Correcting a common misconception, he noted that "risk measurement" is inaccurate terminology since risks are evaluated, not measured. Ingram suggested that a comprehensive ERM program should evaluate both risk tolerance and effective risk appetite and proper disclosures coupled with clear, transparent communication were essential. He closed by hinting that future task forces of the International Actuarial Association may expand and create a global standard for actuarial ERM practice. ☆