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Editorial

MAKING THE CERA A GAME-CHANGER

BY JAMES RAMENDA

ANYONE WHO DOUBTS ACTUARIES' abilities to anticipate and plan for future events need only consider the SOA's ultra-timely development of the CERA credential. The first CERAs were minted just prior to the outbreak of the worst financial crisis in 70 years and through great effort and leadership by the SOA it appears likely the CERA credential will be the recognized global standard for rigorous analysis of enterprise risk. The fact that the financial crisis quickly turned into a general business crisis across many industries and an economic crisis across many countries strongly reinforces that the CERA skill set should be highly valued beyond financial services. This notion dovetails very well with the oft-stated desire by many CERAs/actuaries to expand their roles beyond the traditional insurance, health care and pension areas.

How does this potential for growing the scope of our profession become a commercial realizable opportunity? The first step is to recognize that businesses deal with critical issues through very well-defined governance processes. The professions that have the most prominent "seats at the table" are those whose services are embedded in the governance process. Presently, the professions that best fit this description are lawyers and accountants. Lawyers, of course, are indispensible because they pursue/defend litigation, advise companies and their directors how to avoid plaintiff litigation, prepare regulatory filings, etc. Accountants are most visible in their traditional role of providing the independent external audit and accompanying opinion. But as we see in today's world, accountants now play a much-expanded role in the governance process, thanks in large part to Sarbanes-Oxley. This goes beyond the preparation of the famous "boxes" that need checking. For example, the SEC requirements for the board role of Audit Committee Financial Expert can be filled quite precisely by an accountant with audit experience.

The next step in examining the opportunities is to note the formal aspects of how these professions take part in governance. Certainly, there are people from all walks of life on boards, as well as providing services to boards. But the legal and accounting professions do so in a very well-established, formal sense. They are not just smart people rendering advice as needed. Their services are defined (for example, legal opinions for lawyers, audit opinions for accountants) so as to specifically require the credentials they hold, and these services are integral parts of the annual cycle of governance activities. For the accounting profession, in particular, this enviable position is even more impressive when one considers that many of the services accountants now perform didn't exist in the past and, indeed, were established to address the scandals of 10 years ago (Worldcom, Enron, et al.) that were, in part, accounting-related. In short, the scandals were a "game-changer" for the accountants, but ultimately in a good way —one of the great turnarounds in American business history.

The game-changing idea for CERAs is this: Require as part of the governance process an "independent risk audit" performed by a CERA. This would be an audit of the risk management process that would be analogous to the independent accounting audit, including formal opinions. This would not replace internal ERM but would function in the same way the independent accounting audit works relative to internal accounting. While this proposal may seem a long way from where we are today, its merits seem compelling.

1. The accounting opinion is a point estimate, one selected from among many estimates that are plausible and many more still that are possible. The risk opinion would recognize this entire range of possibilities and associated probabilities. Companies fail because of tail risk, not outcomes close to best estimates or centers of ranges

2. If somehow one were able to "redo" the governance process starting with a blank piece of paper, which audit would be more useful? Since the point estimate is a subset of the range analysis, it would seem clearly to be the latter. If anything, it seems more logical that the accounting function should be part of the risk management process, the latter being a more comprehensive attempt to view all of the risks faced by the firm, including accounting risk.

3. Internal ERM works if the entire corporate culture is accepting of it. Unfortunately, this means it will tend to fail in cases where it is most needed. The most visible example provided by the financial crisis is Lehman, where the hidden leverage posed by so-called Rule 105 Repos was dutifully reported by an internal financial officer to his superiors, who promptly fired him. An external ERM audit very well may have flagged this situation, even as it passed muster with the accounting audit.

An important aspect of this proposal is that it is not limited to insurance, just as the formation of Risk Committees is not limited to insurance. After all, that's what systematic risk is all about, to say nothing of the non-systematic risks that arise in all industries. The CERA having its roots in the financial sector is actually fortunate from a timing perspective in that systematic risk, for now at least, is associated most commonly with this sector.


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When one considers the alternative, leaving ERM to internal processes, augmented or perhaps not by external experts, the outcome seems fuzzy. There is a wide array of risk management credentials out there, to say nothing of others capable of shifting into this space—CFAs, MBAs, quants—and no guarantee that the practices that evolve will be standardized or effective. Creating a formal role in governance as outlined here is no small task, but with so many forces converging that could lead to a game-changing outcome for CERAs/actuaries, it would seem if ever there is a time for this idea, it is now. If we agree that ERM is critical to the governance process, and we agree the CERA is the most rigorous global standard, why shouldn't we have a seat at the table? A

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