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Education

THE VALUE OF ERM

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HERE WE ARE, about half a decade after the start of the recent financial crisis. The economy is still recovering and regulators are putting structures in place to prevent the same thing from happening again. Not only that, but they are looking to prevent anything even remotely similar from happening. One of the areas of focus is enterprise risk management (ERM) and a company's ERM framework.

In this post-crisis era, own risk and solvency assessments (ORSA) are emerging as a requirement for insurance companies in many countries, including Canada, the United States, Australia, Europe and China. The ORSA starts with the insurance company and includes the whole group of companies with which the insurance company may be affiliated. The National Association of Insurance Commissioners (NAIC) ORSA guidance manual states two primary goals:¹

1. To foster an effective level of ERM at all insurers, through which each insurer identifies, assesses, monitors, prioritizes and reports on its material and relevant risks identified by the insurer, using techniques that are appropriate to the nature, scale and complexity of the insurer's risks, in a manner that is adequate to support risk and capital decisions; and

Enterprise Risk Management Framework

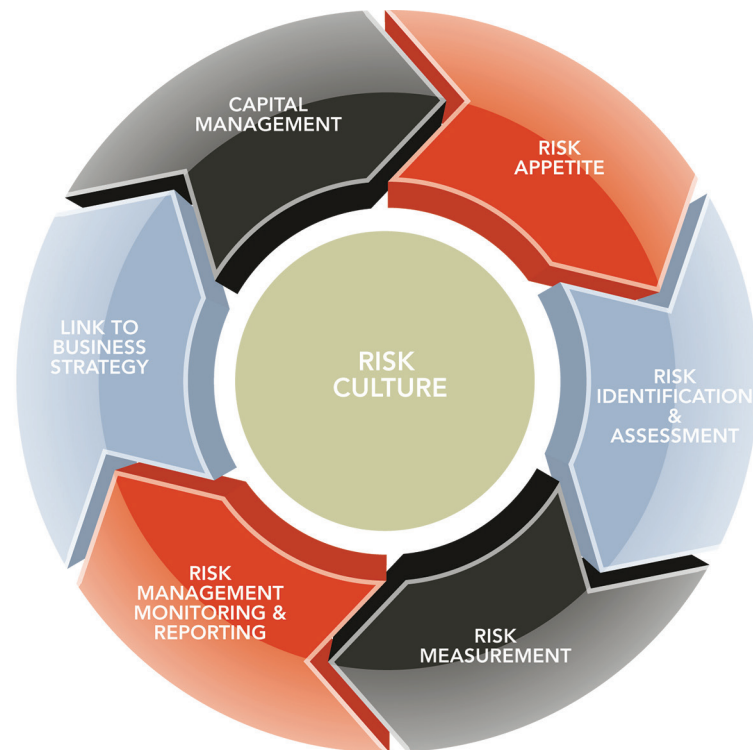


Diagram used with permission. The original version appeared in the essay, "Understanding ORSA Before Implementing It," by Anthony Shapella and Owen Stein.

2. To provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view.

ERM practice has been growing and evolving since the financial crisis. However,

the enactment of ORSA will push a company's ERM practice to the next level. The ORSA is a summary documentation of the company's risk management framework and risk analysis. This document will be the starting point for many risk-based financial



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exams and “insurers with ERM frameworks appropriate to their risk profile may not require the same scope or depth of review upon examination and analysis as those with less relatively comprehensive ERM frameworks.”² This implies a substantial benefit for those companies with an appropriate ERM framework. The chart on page 30 shows what would be encompassed in an ERM framework.

The goals set out by the NAIC ORSA guidance are well suited for actuarial input as they require the identification, quantification and aggregation of the company’s risk. An actuary’s knowledge of these areas also means they are the professional best suited to create the ORSA summary document and communicate the results to others. This is certainly an area where an actuary can lead the company to fulfill the ORSA requirement.

An ERM framework used by a company to drive real business decisions and achieve its business purpose is an underlying goal of the ORSA requirement. The ERM framework needs to benefit the company, and should not be done just to fulfill the minimum regulatory requirement. In the development of the ERM framework, actuaries have the opportunity to show that they are the risk experts at their company.

The chartered enterprise risk analyst (CERA) credential is a valuable asset to have, given this increasing importance of ERM within companies. The CERA credential shows the actuary is knowledgeable of ERM criteria and skilled in the techniques of assessing and analyzing risks. This includes understanding risk aggregation and risk mitigation techniques. With the growing globalization of insurance companies, the CERA is an actuarial ERM credential recognized around the world.

ERM is applicable to all companies and all education tracks within the SOA. As such, in 2013 the SOA redesigned the FSA pathway to make it possible for candidates in all tracks to earn their CERA credential on the way to attaining fellowship. In the past, only the candidates on the finance/ERM track attained their CERA on the way to their fellowship designation. In the old education system, other tracks had different FSA requirements, generally two six-hour written exams and several FSA-level modules. The redesign now gives candidates on all tracks the opportunity to attain the CERA credential on the path to fellowship.

The redesign generally converted the two six-hour FSA-level exams into two five-hour exams plus a two-hour exam. The FSA-level requirements for the CERA credential include passing the four-hour ERM exam and the ERM module. Under the new requirements, candidates in all tracks have the option of replacing the two-hour exam with the ERM exam and including the ERM module in their pathway. Thus, all candidates now have the opportunity to receive their CERA credential, as well as their FSA, on their pathway to fellowship. As shown by the ORSA requirements, ERM is important to all practice areas and companies.

The path to the CERA credential provides valuable ERM knowledge. The exam and module provide education in general ERM analysis and techniques, risk aggregation, risk measures, and risk and capital management, and provide the candidates the opportunity to apply what they have learned. The exam also includes a case study and track-specific extensions where candidates can gain a better understanding of how ERM applies to their practice area and that of a sample company.

Regulation is moving to ensure that companies have a meaningful analysis of their risks, both at the company level

and at the group level. ERM is an area of current and future expansion and growth and an area in which all actuaries should develop an understanding. A well-developed actuary should be able to understand how any risks assumed impact the company and group.

ORSA demonstrates the expanding requirement of ERM in the insurance industry. However, the insurance industry is not alone in using ERM; it is being used in banking and other industries. This provides an opportunity for actuaries to expand further into other industries, especially with the CERA credential. **A**

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END NOTES

¹ NAIC Own Risk and Solvency Assessment (E) Subgroup of the Financial Condition (E) Committee, *Own Risk and Solvency Assessment (ORSA) Guidance Manual* (March 2013), 1.

² *Ibid.*, 5.