



SOCIETY OF ACTUARIES

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# Risk Management

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# Chairperson's Corner

By Stephen Lowe

**IN MANY WAYS, LIFE AND CASUALTY** actuarial work are different. Life insurance policies are mostly about timing, as people die once and only once, and receive a pre-agreed benefit upon death (except for Elfege Baca who had nine lives, according to Walt Disney). In contrast to life insurance, auto insurance policies are about claim frequency and severity, as drivers can have any number of accidents with widely varying costs (a famous boxer is reported to have destroyed three Ferraris in a four-month period). As a result of these differences pricing and product development work is naturally different between the two sectors. However, the one area where I believe there is much commonality is risk management. This is what drew me to the Joint Risk Management Section (JRMS), which is jointly sponsored by the CIA, CAS, and SOA to provide a forum for shared research, development, and communication on risk management issues.

In the last issue, Barry Franklin described three current and proposed areas of research being supported by the JRMS:

- **How to review an ORSA** — The new global ORSA requirements will require insurers to test their capital in relation to their business plans over a multi-year planning horizon. The ORSA requirement is not a new report that must be produced and delivered to regulators (although the production of some type of report is probably inevitable); the developers of ORSA envisioned it as a process through which senior management and the Board would engage in an assessment of the risks facing the enterprise. If the original vision for ORSA is to be realized then the review of the ORSA (by regulators, auditors, etc.) must also be more engaging than reading a report. Since we expect that actuaries will be integrally involved in ORSA activities, we should be able to suggest ways to maximize the effectiveness of the review. The JRMS is planning to launch a call for essays on this topic.
- **Model Validation** — Model risk is a critically important topic for actuaries. As risk measurement models go main-stream at companies, there will be increased reliance on them as decision support

tools. As the builders of models, actuaries need to take care that we aren't materially adding to the risk, rather than just measuring it. The JRMS is encouraging research to provide practical guidance to actuaries in the validation of risk measurement models.

- **Incentive Compensation** — To one degree or another, employee behavior is influenced by incentive compensation plans. This can be a good thing, if the incentives are aligned with the success of the enterprise; however, misalignment can create potentially powerful motivation for behavior that is at odds with good risk management. The JRMS has recently completed a very successful call for essays on this topic, with three prize papers published in the previous issue.



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As the outgoing Chairperson of the JRMS Council, I'd like to highlight a few additional activities and accomplishments of the JRMS.

- **2013 ERM Symposium** — Under the leadership of Rebecca Scotchie, a joint committee developed and put on an excellent ERM Symposium in April. The program was strong and varied, with just about something for everyone. The JRMS sponsored Sheila Baird, former Director of the FDIC, as a luncheon speaker. During the financial crisis, Sheila was at the center of the storm. In addition to providing insights into the crisis, she offered her own perspectives on how shortcomings in risk management were a contributing factor. While the crisis wasn't primarily in our sector, there are still lessons for actuaries to learn from it.
- **JRMS Webcasts** — The JRMS has sponsored several webcasts, and has plans for additional webcasts, focused on topics of interest to risk management practitioners. Topics include: stress and scenario testing, ORSA, risk taxonomy, and extreme risks.

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- **Digital Library** — The JRMS is considering the development and implementation of a digital library that would make books on ERM available to members of the section. Books would be downloadable to a variety of e-readers, and could be borrowed at no cost. Like any other library, books could only be borrowed for a limited time and could not be borrowed by someone else until returned. While there are lots of details to be worked out, this seems like a good way to make materials available to members as a

value-added service. We are also thinking that if we go forward with the library, we will need a panel of reviewers to identify the best materials to be added to the library.

The JRMS Council held its annual planning session in November, where we reviewed our activities and assessed our priorities for 2014. The section is very interested in your thoughts and ideas on any areas that you believe should be an area of focus. ■

## Recent Publications in Risk Management

**"Asia-Pacific regulatory developments – at a glance,"** From the KPMG report, **"2013 Evolving Insurance Regulation: A new dawn."**  
<http://www.kpmg.com/global/en/issuesandinsights/articlespublications/evolving-insurance-regulation/pages/evolving-insurance-regulation-2013.aspx>

**"Applying Fuzzy Logic to Risk Assessment and Decision-Making,"** by Kailan Shang and Zakir Hossen  
<http://www.soa.org/Files/Research/Projects/research-2013-fuzzy-logic.pdf>

The Casualty Actuarial Society, Canadian Institute of Actuaries, and the Society of Actuaries' Joint Risk Management Section is pleased to make available a research report exploring areas where fuzzy logic models may be applied to improve risk assessment and risk decision-making.

**"Policyholder Behavior in the Tail Risk Management Section Working Group Variable Annuity Guaranteed Benefits 2012 Survey Results"**  
<http://www.soa.org/Files/Research/Projects/research-2013-policy-behave-2012-survey.pdf>

The mission of the PBITT working group is to examine and ultimately give guidance to actuaries on how to set policyholder assumptions in extreme scenarios. As part of its work, the PBITT working group issued its seventh survey to gather the range of assumptions actuaries use in pricing, reserving, and risk management of minimum guarantees on Variable Annuity products, such as death benefits, income benefits, withdrawal benefits and maturity benefits.

**"Incentive Compensation – The Critical Blind Spot in ERM Today"** <http://www.soa.org/Library/Essays/jrm-2013-essay-incentive-comp-toc.aspx>

The Joint Risk Management Section of the Society of Actuaries (SOA), the Casualty Actuarial Society (CAS) and the Canadian Institute of Actuaries (CIA), in collaboration with the International Network of Actuaries in Risk Management (IN-ARM), are pleased to release our fourth essay e-book, this time addressing "Incentive Compensation—The Critical Blind Spot in ERM Today."

**"PBA Implementation Guide"**  
<http://www.soa.org/Research/Research-Projects/Life-Insurance/research-2013-pba-implementation-guide.aspx>

The Smaller Insurance Company and Financial Reporting Sections are pleased to announce the release of a new research report to provide a better understanding of the key considerations an insurer would encounter in making a principle-based framework for determining reserves and risk-based capital (PBA) a reality.