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Where are your ERM blind spots?

By Stuart Wason

WE ALL HAVE THEM. We may not want to admit that they might exist. We tend to focus on what we have, not on what we might be missing. What well intended incentives might be in play that are misaligning intended behaviors and leading to unexpected consequences and perhaps systemic risk? I am of course referring to our ERM blind spots. Have you given thought to where yours might lie?

We tend to learn from past mistakes. With each crisis or ERM challenge, we identify the problems and change our practices for the future. Inevitably, changing ERM practices (whether they be individuals, companies or regulators) lead to shifting incentives in markets. With the pace of change increasing by leaps and bounds and the inter-connected nature of the world in which we live, it is important that ERM include deliberate consideration of its own blind spots.

Stuart F. Wason, FSA, CERA, FCIA, MAAA, HONFIA, is senior director at the Office of the Superintendent of Financial Institutions Canada in Toronto, ON. He can be reached *stuart.wason@osfi-bsif.gc.ca*.

Blind spots can occur for many reasons. One might occur due to an over-reliance on a single risk metric. No doubt you have heard the debates over use of VaR or TVaR (CTE). What about the use of different time horizons—quick shocks versus modeling longer term ripple effects? How about reliance on regulatory Pillar 1 measures versus your own independent modeling of the risks and also various Pillar 2 (e.g., ORSA, stress test) type techniques? Which valuation measures, consistently applied across your business, provide a more useful basis for decision making—amortized cost, past experience, current market experience, others, etc.? Will the markets of tomorrow behave as they have in the past (e.g., dependencies, volatility etc)? Will human behavior, individually and collectively, change in the face of future crises? These are just a few examples of key ERM assumptions which need to be continuously reviewed. Over-reliance on one answer to each of these questions can leave us open to an ERM blind spot.

Your section council recently met to consider our services to you, our members, in the coming year. You will be hearing more about the programs we propose in the coming months but our goal is to encourage research and discussion on topics such as ERM blind spots. The planning for the spring 2012 ERM Symposium in Washington DC is well underway and I highly recommend this successful event as an excellent opportunity for ERM learning and networking with experts from a range of ERM perspectives. In addition to our research program, newsletters and sponsoring of ERM sessions at many actuarial meetings, we plan on outreach to regional actuarial clubs. We are particularly excited about a planned series of planned one hour webinars through the coming year on topics such as credit risk, market risk (including ALM), group/conglomerate issues and ORSA. In conducting these webinars, the JRMS focus will be on the ERM aspects of the subjects and we will collaborate with other specialist groups/sections to provide the technical aspects of these topics.

I do hope that you will find value in your JRMS membership this year. I also hope that you will spread the word to your colleagues not only of the JRMS programs but more fundamentally that ERM is a necessary part of our daily lives, for personal and business decision making. The current ongoing global crisis, which has been more severe and long-lasting than many would have expected, is a clear example of the importance of ERM for all decision makers, not just CRO's. Where are your ERM blind spots? ■