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Towards a Risk Management Profession

By David Ingram

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DURING THE DOZEN OR SO YEARS THAT I HAVE BEEN VOLUNTEERING FOR SOA PROJECTS RELATING TO ERM, I have heard many, many actuaries say that all their work is about risk—risk measurement and management. But risk management has been changing and evolving over that same time period. Company practices have evolved. There are new developments on the regulatory front. The actuarial profession first responded with a new educational certification, the CERA, and is now working towards professional standards of practice.

Insurance solvency regulation is moving into new territory. Insurer and reinsurer management and boards will now be required to issue a statement that reflects their judgment about the firm's viability, including its capital adequacy. This is an abrupt shift from the longstanding practice where regulators specified the exact basis for assessing insurer solvency. This will require management and the board to develop new thinking about risk, risk management and capital. They will need to agree upon the risks, the risk management capacity, and the necessary capital as well as the impact of future plans of each insurer, instead of operating in the safe harbor that is specified by the regulator.

This change is due to an agreement in October 2010, by the international insurance regulatory community to adhere to a set of Insurance Core Principles (ICPs). This new requirement for solvency, ICP 16, is titled Enterprise Risk Management. ICP 16 calls for an Own Risk and Solvency Assessment (ORSA). This ORSA requirement was already embedded in Solvency II within Pillar 2. In the United States, the National Association of Insurance Commissioners (NAIC) has issued a proposal to implement the ORSA, which was recently under comment. It seems clear from the NAIC's approach and language that they are not looking for opinions about whether to implement the ORSA requirement, but were soliciting suggestions with regard to the specifics of implementation.

Prior solvency standards, such as the NAIC's Risk-Based Capital regime, imply that an insurer is deemed to have enough capital if it passes a certain dollar amount. The critics point out that large U.S. banks were meeting the Basel II solvency standards when they experienced very large losses and needed bailouts to stay in business. By making management and the board responsible for certifying solvency, the expectation is that they will do a better job of reflecting and monitoring the actual risk position and capital needs of the insurer.

ICP 16 requires that five elements of a risk management system be reflected in the ORSA opinion: identifying risks, measuring risks, a risk feedback loop, a risk tolerance statement, and a risk policy.

Actuaries can and will have a major role in this emerging process. Some firms will need assistance in building the processes needed to measure and manage risks, some will need help in documenting and explaining the processes that they already have in place, and a few are already well prepared. Much work is needed for actuaries to be ready for a major role in accepting the responsibilities of these new requirements. A major part of that process is education. That work is well underway with the addition of the CERA credential and related syllabus materials. This coursework provides actuaries with the educational background needed to operate as risk management professionals. To obtain a CERA, a student must master the methods that are used for risk management. Another part of that process is developing professional standards that define for practitioners, potential employers and others, such as regulators, what an actuarial risk management work product will include. The Actuarial Standards Board (ASB) has started work on that as well.

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In 2010, the ASB commissioned a task force to look into whether a need existed for a new standard or standards for ERM practitioners. That task force has come back with a pair of discussion drafts that were posted for comments to the ASB website in March. Separate documents cover risk evaluation and risk treatment.

If you agree that all your work is about risk measurement and management, then no matter what your area

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of practice, please make the effort to read the discussion drafts on risk evaluation—they may have a significant impact on your practice.

If you are reading this as one of the many SOA members who practice outside the United States, you might be thinking that this applies only to U.S. actuaries. You may be surprised here. The International Actuarial Association (IAA) has a process to develop model standards of practice that may be adopted by any member association for use in its country. The IAA recently empanelled an ERM task force to develop one or more model standards on ERM. These new ASB discussion drafts may well be the starting point for the IAA work, so your attention to them is important.

The newly developing ORSA requirement of the regulators is a natural reaction to the failures of regulation and risk management of the financial crisis. The actuarial profession is keenly placed to step up and provide uniquely well-educated and professional assistance to this process. Creating a standard of practice in a developing field such as risk management is a new challenge for the actuarial standards setting process. A spirited debate is expected to result from the discussion drafts.*

At a recent session discussing ERM standards of practice at the ERM Symposium, Bob Mark, a well-known author and Professional Risk Managers' International Association (PRMIA) board member, remarked that he did not know of any organization that was working on standards of practice for individuals practicing in the risk management field. This vacuum provides an opening for actuaries to establish the first set of such professional standards in the field of risk management. At this point in time, the entire actuarial profession is a small fraction of the total number of people who are practicing risk management. But with the educational standards as expressed by the CERA and the professionalism that will be codified by the new standards, actuaries will certainly be seen as the source of some of the best risk management work available. ■