Article from

Risk Management

April 2017
Issue 38

Editor's Note

By Baoyan Liu (Cheryl)

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair …"

—A Tale of Two Cities, Charles Dickens, 1859

I begin this "Editor's Note" by applying one of the great opening sentences of any novel to the current economic and political situation. The year 2016 saw a sea change in politics, first the shock of Brexit passing then President Trump's victory. "Black Swan" might be the word that you heard the most in risk management these months. If you recall, in the first 2016 issue of *Risk Management*, we included an article on preparing for the unthinkable—"Black Swans and Risk Management." Most companies started the Black Swan evaluation as part of their emerging risk management. The article also discussed how companies can both address the unknown and, at the same time, ensure they are agile enough to react when the seemingly unthinkable occurs. Into 2017, I agree with Warren Buffett that risks of being out of the market are huge compared to the risks of being in it.

In this first issue of *Risk Management* in 2017, we'd like to share with readers articles from various angles of the risk spectrum.

Though most ERM practitioners agree on the importance of a risk appetite framework (RAF), there is less alignment on its critical goals, implementation, and even relevant terminology. In "Risk Appetite: An Axiomatic Approach," Damon Levine avoids debate regarding terminology and, instead, illustrates a RAF with those elements most often regarded as best practice.

We also provide insights on international capital requirement. The International Association of Insurance Supervisors (IAIS) has moved one step closer to the release of its capital standards for Internationally Active Insurance Groups (IAIGs). While these standards are meant to apply on a group basis and not to individual legal entities, there is often a trickle-down effect so all practitioners need to be aware of what is transpiring. Tom Herget gives us an update on the development of this standard. He outlines the concepts and features that actuaries need to deal with, as well as key areas still to be addressed and timetable ahead. In addition, we are pleased to include an abbreviated version of the "International ORSA Regulatory Requirements Chart" from the International Actuarial Association. In this issue, the content of this International ORSA Regulatory Requirements Chart has a focus on U.S., Canada, Europe and Bermuda.

What is the role of a CRO? How do CROs lead insurers forward on the ERM journey? Ernst and Young has run an annual survey of Chief Risk Officers (CROs) since 2010. Over the period, the survey has charted the evolving role and authority of insurance CROs, as well as the development of ERM capabilities. We have an article in this issue with selected highlights of key outputs through four of the key themes of the survey: maturation of risk management; CRO roles, responsibilities and reporting lines; ORSA — one year in; and risk appetite.

Economic Capital (EC) framework has been commonly used to quantify risk and capital. As a common practice, the final step in calculating EC is risk aggregation. The presumption is that the EC required for an enterprise is less than the sum of the individual risk exposures due to diversification benefits. Instead, in "Risk Aggregation and Risk Magnification," Feng Sun provides evidences of the opposite of risk diversification (or risk magnification), and discusses a potential change of the way insurance companies quantify and manage the risks.

In this issue, we continue the cyber risk discussion, and share with readers an article on "The Complications of Cyber Risk Quantification." For corporate management and their boards, cyber threats and their costs are a continuously evolving, moving target and a source of uncertainty. While the need for robust security is self-evident and attracting significant investment dollars, demand is building for insurance products that can provide an important risk management backstop.

Last, based on a recent survey of our section's membership, our members indicated that they want to know more about the section's e-library and its contents. Here in this issue, some useful information about the JRMS e-Library is included. And as usual, we provide a list of recent articles and papers that may be of interest to our members. These pieces can provide further information on a broad range of topics.

We would like to give a special thank you to David Schraub and Kathryn Baker for helping us pull together this March newsletter.

Happy New Year and Wish you a good year in 2017! Enjoy reading!

Baoyan Liu (Cheryl), FSA, CFA, is senior manager, financial risk management at FWD Life Insurance Company (Bermuda) Limited in Hong Kong. She can be reached at *cheryl.by.liu@fwd.com*.