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Conversation with a CRO: An Interview with Lori Evangel

Lori Evangel, CRO of Genworth Financial

In this, the second in our new series, "Conversation with a CRO," in which we engage in open and candid Q&A with top practitioners in the insurance industry, *Risk Management* is honored to have been given the opportunity to interview Lori Evangel, CRO of Genworth Financial.

Lori was interviewed over the phone on May 1, 2018 by Tony Dardis, of Milliman, Inc. and Awa Koné, of Swiss Re.

Lori Evangel describes herself as someone who gravitates toward opportunities where she can build or fix key risk organizations, based on the ever emerging best market practices occurring in the field.

Lori is the CRO, and part of the senior leadership team, of Genworth, a writer of both mortgage insurance (primarily in the U.S., Canada and Australia) and Long-Term Care (in the U.S.), and a company that has as its mission providing products for key moments in life such as first home ownership and to assist in the challenges of aging.

Lori has been very honored by the opportunities given to her. Prior to joining Genworth in January 2014, Lori held the position of CRO of AFLAC's Global Investment Division, and prior to that served as the Enterprise Risk Officer at MetLife. She was tasked with building an integrated global risk function after the acquisition of ALICO from AIG, which transformed MetLife into a major worldwide player spanning many countries. This was a huge challenge in itself, but was further complicated by the fact that it was happening at the height of the financial crisis.

Lori also served in key risk management and other positions at MBIA Insurance and Moody's Investor Services.

Not surprisingly, our discussion with Lori proved to be a whirlwind trip—fasten your safety belts.

Q: What would you view as the biggest issues facing the insurance industry today?

A: The insurance industry in general is trying to figure out how to stay relevant. By that I mean we've had a very significant change from yesterday's generation to today's generation in terms of how customers view insurance: the products that they feel they need; what they are willing to pay for these products; and finally the channels through which they want to buy these products.

For generations, people bought the same type of products in a similar fashion. They tended to think about insurance in terms of catastrophe, and getting protection against catastrophes, and insurance was sold to them via a broker. Today's generation does not think in this way—we are witnessing a generational shift. This generation tends to think of insurance as to how it fits within their overall wealth accumulation strategy, and their spending habits; they also want to be able to use the internet to not only compare different products but also to make purchases.

They are not necessarily thinking about what they need long term. Additionally, macroeconomic events such as the financial crisis have delayed events such as marriages and having children, which are key times when people start to seriously consider insurance. As a result, the industry needs to determine what consumers want and how we can design and distribute affordable products which would be of interest to these consumers.

Then to supplement this fundamental generational shift, we have two other huge paradigm shifts taking place.

The first paradigm shift concerns the granularity and nature of data we are starting to collect on the insured population. This is a double-edged sword, in that on the one hand, an insurer having access to more detailed data on an individual gives us the scope to more effectively underwrite that individual. But on the other side of the coin, developments such as DNA testing may enable customers to get greater insights into their health status than the insurance companies do; and this can potentially lead to their self-selecting when it comes to certain insurance products, which ultimately creates the potential for adverse selection against the insurer. We must ask ourselves, is there a danger that we are starting to move away from the concept of risk pooling that is at the very core of insurance? That we may no longer be able to rely on the law of large numbers; with a truly universally representative population, can we still expect that group to act in a similar fashion?

The second paradigm shift is the uncertainty around future mortality and morbidity. We have had long periods of mortality improvements, fueled by medical advances, which allowed people to live longer lives. There have also been tremendous advances in medicines for cardiovascular disease. And there may yet be important advances in the diagnosis and treatment of Alzheimer's. However, we are now faced with ailments such as diabetes and obesity that are affecting a younger portion of the population much earlier than previously and spreading across the globe. This is a challenging situation because these diseases actually require lifestyle changes (as opposed to medications). These issues will have a big impact on claims for the insurance industry associated with mortality and morbidity, the age at which people die, and the severity of LTC claims.

The generational shift, along with these two paradigm shifts, in combination, create both challenges and opportunities for product design, underwriting and pricing. I am not an actuary, but actuaries usually assume that the wealth of historical data will help predict the future. What I worry about is how these paradigm shifts are going to change the future predictability of historical-based assumptions.

Q: What are things that can be done to ensure a successful "risk culture" in an insurance organization? What can CROs do to make risk management part of their company's strategic decision making?

A: Having a risk culture is extremely important.

The centralized risk unit, or second-line-of-defense, can't legislate how risk is managed. As a CRO I cannot do this by myself. Risk management needs to flow throughout the organization. This can only be achieved by having a risk culture. By the way, it is very hard to change a bad risk culture, if you let that manifest itself.

In my view, there are four hallmarks of a good risk culture:

- Every employee understands the mission of the company, what is acceptable and what is not. This message is something that needs to run through the DNA of the company. If you have a firm of say 30,000 employees, you can't legislate their every behavior, but you can communicate a mission to them. I have seen some CEOs and boards do this brilliantly. It is essentially important.
- There needs to be a clear alignment between what the company is trying to achieve, and the risks it is willing to take in order to meet these objectives.
- The right "tone from the top" needs to be set. This means that the CEO and board have to be risk-focused. And people have to feel empowered to come forward when there is a problem—that it is ok for people to communicate to senior management that something is going wrong.
- The Three Lines of Defense model is important, however it is essential that the role of the first line is emphasized. The business lines are the closest to their operations and therefore have the deepest understanding and the resources; so if there is a risk issue they are the ones that have to be comfortable with the remedial action and should be the ones to act. They should be accountable and responsible. Then the role of the second line can focus on setting risk policies and guidelines, and reviewing that procedures followed by the first line are in accordance with those policies and guidelines. The third line can then undertake assurance and advisory activities to check that all is working properly and controls are functioning as designed.

As the CRO, I view my primary job as making sure that the policyholders get paid for as long as we are contractually obliged.

Therefore I take a long-term view of the business and risk. Managing the two sides of meeting shorter-term shareholder expectations versus providing long-term security for our policyholders is not always easy, but it is critical to ensure that the latter is never compromised.

Q: How do you think the insurance industry should be responding to the LTC coverage needs of the North American population? What are the prospects for the LTC industry?

A: I think LTC insurance is an important tool in helping people manage their assets and wealth in older age. I believe in the product intensely. The product is needed by consumers even though they may not know they need it. And if we don't find private solutions to providing LTC needs, it will end up becoming a huge strain on local governments. People will look to the public sector for assistance, and the taxpayers will be picking up the tab.

Unfortunately, in the past the product was not appropriately understood in terms of the risk and the size of claims relative to the size of premiums. The industry charged fixed premiums, as if LTC was similar to term insurance, and did not have the expectation of a changing premium over time that would provide profitable business as experience on morbidity, mortality and interest rates emerged. This is a very different model from health insurance, or auto insurance, where there is a recognition that premiums will change over time to better coincide with the changing environment and emerging claims experience. The biggest mistake made by the industry was not realizing the importance of having a product that could be re-rated over time, to recognize the many uncertainties around future events that is inherent in LTC. The industry did not totally appreciate the dynamics of how long people would live, what would cause people to go on claims, for how long and what kind of care facility they would go to. Everyone in the industry made the same mistake.

The industry is now seeking to design and develop products that will both be affordable to and meet the objectives of the consumer, and provide a reasonable risk/reward and profit proposition for the insurer. We need to design products that are simple to understand, and represent a good value-for-money proposition to consumers.

If we can get there, the industry will be viable again—and I strongly believe we will get there.

Q: Notwithstanding some element of relief recently, "lower for longer" interest rates continues to be an issue for all long-dated liabilities, including life insurance and LTC. What are some of the things that companies can be doing to help better manage this particular risk?

A: This situation has been the bane of the insurance industry for the better part of the last decade plus. There is a school of thought that interest rates will revert back to a higher mean. However, there is also strong evidence over this cycle that interest rates are not completely solely subject to market forces, but that government actions have kept interest rates low. In fact, due to many forces, we have had a long period of declining interest rates.

We may need to start thinking about this in terms of maybe another paradigm shift. Perhaps interest rates might not fully revert to their historical mean; that the shorter end of the curve may increase, but the longer end not as much (flattening). We might, in our models, have to assume lower interest rates for longer, and continue to determine the impacts on our companies.

LTC of course poses particular problems as the liabilities are such long duration, therefore we face a very considerable long-term exposure when realized interest rates are persistently below what we have assumed in our pricing. So, it gets back to the need to have flexibility in the product design, such as having the ability to increase premiums or reduce benefits during the course of the policy.

Of course, hedging is also an important mitigant and utilized by all insurance companies. For hedging to work effectively, you need to have a well-developed derivatives playbook and be constantly in the market.

All insurers with long-term liabilities are now addressing the issue head-on and looking at ways to create additional yield without taking undue risk, whether that be by going longer on their asset durations, or by adding alternative or equity-based asset classes.

Q: What role can economic capital (or internal capital) have? What are potential barriers to a successful economic capital program and how can insurers overcome them?

A: I am a big fan of economic capital—I believe in it. However, while I think it is extremely important, it needs to be married with stress testing. Presenting, for example, a 1-in-200 event to management, which can be considered just a theoretical number, makes it hard for management to pay much attention to EC. But if you can link that to what you're doing for stress testing, it helps to bring economic capital to life and can be very valuable.

Economic capital lets you see the changes in the value of the company if a very bad event occurs. It thus gives an early warning signal, and essentially enables you to take advance action. The key is to make economic capital actionable. Companies can do this, first by marrying it with stress testing, and then linking it to mitigating strategies. This is what will get the attention of the board. Going to the board and saying "our economic capital

analysis tells us that we need to take certain mitigating actions" is something that is going to get a lot of attention. It gets economic capital away from the theoretical and makes it real.

Q: Cyber risk has gained increasing focus in recent years. What would you view as some of the biggest issues around cyber risk and how to best manage these issues?

A: Most insurance companies have a very significant amount of personally identifiable information (PII). We know a lot about our customers, so every insurance company in the world should be worried about someone hacking their data and the potential actions they might take with that data.

I worry a lot about cyber risk. Unfortunately, it is impossible to set up mechanisms within your company to perfectly protect against a breach of your systems and data. Despite all your efforts, it is important to recognize that there will always be players ahead of your defense mechanisms. So, it is important to also focus on your business continuity mechanism, and how quickly you can respond to a cyberattack—the question of "velocity." This matters just as much as the cybersecurity defenses. So, just as a hacker can get into your systems unexpectedly and suddenly, your response also needs to be rapid. In short, while I cannot perfectly protect the company against a cyberattack, I can put things in place to ensure we have a very effective response in case of an attack.

Q: Much attention has been given by the industry in recent years to building out their model risk management capabilities. What would you view as the key to a successful model risk management program?

A: Model risk is everywhere. Everything we do in this industry has a model associated with it. It's an area that has created both challenges and opportunities for enhancements.

A critical aspect of model risk management is ensuring that you have the right model for a given application—that the model is fit-for-purpose. As a risk manager, I also want to know that our models have been properly documented—not always something the teams do with rigor at insurance companies—and finally that the models have been peer reviewed (which means challenged and validated).

It is essential that you develop a rigorous program of model validations to assure the models are operating as you intend, that all is properly documented, that appropriate peer review occurs and that your overall model risk governance program is operating effectively.

Q: How do you see the role of actuaries in the risk management space?

A: Actuaries are a wonderful asset for any insurance company. We can't live without actuaries. They have a deep understanding of insurance and the long-term risks to which we are exposed.

My advice to the actuarial profession is twofold. First, start thinking very hard about the paradigm shifts I mentioned earlier. Are there things that are fundamentally changing in the world around us that could lead to data from the past becoming considerably less useful in thinking about what may transpire in the future? Second, recognize that none of this is a perfect science. Data can help and should be looked at, but don't get caught up in looking at numbers to the nearest decimal point and thinking analytics alone will give you all your answers. Judgement is a critical component to all of this, the decisions we make and future outcomes.

Q: The use of big data and predictive analytics are changing the industry, and look to offer potential to help insurers in a number of areas. What is your view?

A: Big data and predictive analytics offer a great opportunity to help solve the concern I raised earlier about the industry trying to stay relevant and getting a better understanding of consumers' habits and purchasing patterns, and importantly policyholder behavior. Predictive analytics have been used effectively by the banking industry for many years, but it is still early days on how the insurance industry will decide to use it.

I am part of a few risk and CRO forums, and we talk about this topic a lot. The general sentiment is that we do not know whether or not these tools will provide us with solutions to the industry's current challenges, however, we need to keep abreast of the developments. We need these tools as one part of our arsenal to inform the judgement calls we have to make. It can be viewed as another lens for us to look at. A good CRO uses all the tools at their disposal (whether it be economic capital, stress testing, predictive analytics, etc.) to make informed judgements and recommendations. And let's not forget the value of experience. I am absolutely informed by my experience of over 30 years. ■

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