Small Talk

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Enterprise Risk Management for Small Insurers—It's Still Three Words

By Norman E. Hill

After the financial meltdown of 2008, there certainly seems to be more interest in risk management than before. This is true on the part of both insurers and banks. A great many articles have been written, stressing that the mistakes of the past must be avoided. This involves greater emphasis on managing risk.

It is true that some articles, usually from insurance and actuarial publications, use the term "ERM." However, there are also many that confine their usage to "risk management." Many of the latter articles points are valid. However, avoidance of the term "enterprise risk management" seems to undercut the validity of the points they make.

So far, my analysis indicates that insurers are somewhat more likely to use the ERM term than banks. This could be tied to the long-term nature of most life insurance contracts. Even here, though, the usage is by no means universal.

Setting the Stage with "Siloing"

As a preliminary note, a complete definition of the term "silos" seems in order. This term is often used when contrasting the beneficial and corrective aspects of ERM. To some, it might be a turnoff or a jargon-like term. But once understood and used on occasion, it can be helpful.

From the business dictionary, Spirit Lexicon, Entry No. 78 for "Siloing": Types 1 and 2 refer to agriculture usage. But Type 3 is on point: "In business, non-communication between departments, incompatible goal-setting, intra-company snobbery or outright hostility … At its most extreme, siloing in the workplace leads to destructive competition among nominal allies. …"

Discussions Involving Risk Management—Banks and Others

A recent issue of the *RMA Journal*, July/August, 2010, (bank-oriented publication) contains several key articles on risk. The first is a summary of a Toronto, Canada chapter meeting of Canadian bank chief risk officers. Some of the quotes are illustrative:

1. "Process is critical to managing risk. ... The challenge is to ensure that the processes yield value-added content that helps us evaluate old risks as well as new ones. …" *Mark R. Chauvin, TD Bank Financial Group*
2. "Risk management needs to work well with our businesses so that we don't get out in front too quickly or lag behind." *Tom Woods, CIBC*
3. "In the past, compensation issues … were resolved without a whole lot of risk management involvement … Now … boards are looking for risk management to be involved." *Morton Friis, Royal Bank of Canada*
4. "Fundamentals matter, the secrets of the risk management business do not change." *Morton Friis, Royal Bank of Canada*

At a meeting of a New York chapter of CROs, more quotes are similar in nature.

"We meet regularly with the audit committee. … Our CEO, our president … and other people … (are) clearly interested in the risk management of the firm. …" *Craig W. Broderick, chief risk officer at Goldman Sachs*

A key point made in the article was that risk managers must understand and support the firm's business strategy. According to David Coleman, Royal Bank of Scotland, "I encourage people to get out from behind their desks and understand their marketplace, to … be engaged in strategy development."

Discussions Using ERM—Insurance Related Organizations

The above discussions in the New York Chapter seem closer to what is normally thought of as ERM. But they never quite make the leap in using the term in its broadest, most complete meaning.

Several articles in a recent *National Underwriter, Property & Casualty*, April 26, 2010, seemed tied in with ERM, as advocated by the actuarial profession.

The first article is by Mark Anquillare, CFO of Verisk Analytics, parent of ISO. His key points are:

1. "Effectively managing corporate risk today requires the adoption of enterprise risk management—a holistic, dynamic and operations-oriented that encompasses broad areas of responsibility across the entire organization."
2. "ERM offers risk managers the ability to manage risk across the enterprise … (and) contributes to the optimization of risk-related decision-making and alignment of the ERM strategy with the organization's overall risk tolerance and goals."
3. "When implementing an ERM strategy, companies should augment the use of traditional risk data with advanced operational-risk analytics and scoring. …"

"Insurance and actuarial organizations seem more likely than banks to use the term ERM enterprise risk management. …"

On a less positive note, another article in that issue describes key hurdles facing ERM today. According to a recent Aon study, "2010 Global Enterprise Risk Management Risk Survey," only a very small percentage of risk managers (7 percent) rated themselves as advanced in terms of implementing ERM programs. Perhaps more significantly, over one-third of risk managers taking part in the survey stated they were only "getting started" in ERM.

The same Aon survey provides three recommendations for boosting ERM within a firm:

- Appoint an executive level leader to be responsible for driving ERM strategy and implementation.
- Consider having the risk function report directly to the Board.
- The title of the ERM leader is less important than recognition of that person's position within the organization.

Finally, the study cited the primary barriers to ERM within organizations:

- "Lack of tangible benefits (40 percent).
- Lack of skills to imbed a program (34 percent).
- Lack of senior management sponsorship (31 percent).
- Lack of a clear implementation plan (28 percent).
- Failure to communicate the case for change (27 percent)."

Analysis of Aspects of Aon Study

In a previous *smalltalk* article on ERM ("Enterprise Risk Management for Small Insurers (ERM)—An Evolving Concept"), I recommended that, especially in a small company, the chief actuary was the logical choice to be chief risk officer. This would mean that, in the above terms, he would be the "executive level leader to be responsible for driving ERM strategy. …" My own preference would be that he still report to the CEO. I believe this would aid his perception as part of top management, rather than akin to external or internal auditors.

Conclusions

Insurance and actuarial organizations seem more likely than banks to use the term ERM, even when all discussions really pertain to the functions and responsibilities of enterprise risk management. Banks seem sensitive today to the critical need for better management of risks they undertake. But at least some insurance-related organizations see the broader, firm-wide nature of ERM. To them, traditional silos must be overturned so that the entire organization is committed. Emphasis on "risk management," as such, runs the danger of being much too narrowly focused. In other words, ERM is indeed still three words.

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