

## **Financial Crisis: Lessons for Insurers Fact Sheet**

### **Actuaries Analyze Implications of Mortgage Crisis**

#### ***Research Focuses on Insurance Industry, Risk Management for All Companies***

Focusing on implications from the subprime crisis and approaches to address future crises, the Society of Actuaries (SOA) and the Joint Risk Management Section have published the paper, “The Financial Crisis and Lessons for Insurers.” Led by author Dr. Shaun Wang of Georgia State University, the paper analyzes the causes of the crisis, insurance companies’ exposure levels, and potential strategies to reduce the likelihood of future risks. The paper is yet another example of the thought leadership of actuaries in both the insurance and broader financial services industries.

While the paper identifies the subprime mortgage crisis as the catalyst to the U.S. and global financial downturn, the authors address a variety of topics in relation to the insurance industry. The paper identifies, among other items:

- The root causes of the subprime mortgage crisis, one primary cause being the belief that housing prices could not decline significantly on a national basis
- What factors led to insurers’ exposure in these markets (e.g. aggressive investing)
- Risk metrics to measure insurers’ exposure
- Potential issues that insurers will be faced with the current downturn, (e.g., exposures to commercial real estate)
- What may have contributed to insurers’ exposure, such as ineffective regulation
- What types of enterprise risk management (ERM) strategies may have been used and can be used moving forward to avoid similar outcomes (see below)
- The overall lessons for insurers, such as the importance of liquidity management and understanding that diversification can help reduce risk and stabilize financial results, but it brings potential additional risks of which companies need to be aware

Based on their analysis of the financial crisis, the contributing actuaries wrote, “One thing made clear by this financial crisis is that risk management is not a luxury but a necessity... the complexity of today’s financial products and financial engineering underscores the need for an enterprise-wide approach to risk.” They identified nine key recommendations that financial firms and insurers should follow in their approach to risk management:

1. A strong risk management culture must start at the top.
2. Risk management is most effective when used to prevent crisis rather than manage them.
3. The financial system is interconnected, so businesses need to look at what others are doing in the industry, not just their own risks and processes.
4. Establish a robust liquidity management system.
5. Develop a counterparty risk management system and limits.
6. Keep watch on high profit areas, as these are the areas where the greatest risks emanate.
7. Refine tools to systematically aggregate exposures.
8. Understand the limitations of models and the related assumptions.
9. Incorporate a wide variety of economic scenarios for stress tests.

Companies can use these guidelines in helping apply an enterprise-wide approach to risk management. Inside or outside the insurance industry, it is essential to look at ways not only to mitigate risk, but also maximize opportunities for businesses in today’s difficult economic climate.

In conjunction with the release of this research, the American Academy of Actuaries has provided recommendations for regulatory improvements. Specifically, the regulatory recommendations include:

- Developing a systemic risk regulatory structure for the financial services sector

- Determining appropriate constraints and capital requirements on investments
- Establishing new regulatory transparency requirements for rating agencies and third party advisors

For more information on the paper, please visit [www.soa.org](http://www.soa.org) or contact Kim McKeown at 847-706-3528, [kmckeown@soa.org](mailto:kmckeown@soa.org).

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*The SOA, Casualty Actuarial Society (CAS) and Canadian Institute of Actuaries (CIA) jointly sponsor the Joint Risk Management Section. The purpose of the Joint Risk Management Section is to further the education and research in the area of risk management and establish leading risk management techniques.*

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