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Contact: Kim McKeown
Society of Actuaries
847.706.3528 or kmckeown@soa.org

Andrew Simonelli
American Academy of Actuaries
202.785.7872 or simonelli@actuary.org

Mike Nowak
GolinHarris
312.729.4346 or mnowak@golinharris.com

Actuaries Advise Need for an Enterprise-Wide Approach to Risk Management

New Paper Highlights Implications of Mortgage Crisis on Insurance Industry; Public Policy Recommendations Proposed

WASHINGTON, D.C. and SCHAUMBURG, ILL. (September 29, 2009) – Focusing on implications from the subprime mortgage crisis and approaches to address future crises, actuaries in the U.S. have expressed the need for enterprise-wide risk management approaches through business practices and regulatory enhancements. The Society of Actuaries (SOA) and the Joint Risk Management Section have sponsored a new paper, "The Financial Crisis and Lessons for Insurers," providing further insights on the causes of the subprime crisis, and subsequently the financial crisis. Taking the findings into consideration, the American Academy of Actuaries has also put forth recommendations for regulatory improvements to help guard against future crises.

"The burst of the housing bubble and subsequent global financial crisis exposed many structural issues in the broader financial system and weakness in firms' risk management approaches; they must be addressed to avoid another major crisis" said Dr. Shaun Wang, MAAA, FCAS, report author and Thomas P. Bowles Chair Professor of Actuarial Science at Georgia State University. "To move forward, it is essential to develop intelligence about the big-picture environment and address accordingly the near and long-term challenges facing the insurance industry. This applies not only for insurers, but for businesses in general."

While the paper focuses on 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, such as aggressive investing, led to insurers' exposure in these markets
- Risk metrics to measure insurers' exposure
- What may have contributed to insurers' exposure, such as ineffective regulation
- Potential issues that insurers will be faced with the current downturn, (e.g., exposures to commercial real estate
- 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

The ERM strategies that financial firms and insurers should focus on for an enterprise-wide approach to risk management are:

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 examining the mortgage and financial crises, the paper also addresses the related issues of liquidity and diversification, and their roles in the downturn. Diversification, for example, was widely thought to be a solely risk mitigation and profit building strategy. The paper advises the C-suite to understand that diversification brings with it its own risks that need to be considered in an evaluation as well.

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

The research conducted to complete the paper, and the regulatory recommendations developed as a result, are part of actuaries' ongoing efforts to help businesses navigate past the financial crisis and prepare for emerging challenges on the horizon. For a copy of the paper, "The Financial Crisis and Lessons for Insurers," please visit www.soa.org.

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Actuaries bring a complex future into focus by applying unique insight to risk and opportunity. Known for their comprehensive approach, actuaries enable smart, more confident decisions.

About the Sponsoring Organizations
The Society of Actuaries (SOA) is the largest professional organization dedicated to serving 20,000 actuarial members and the public in the U.S. and Canada. The SOA's vision is for actuaries to be the leading professionals in the measurement and management of financial risk. www.soa.org

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.

The American Academy of Actuaries is a 16,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States. www.actuary.org

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