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ERM Opportunities for Health Practitioners

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Health actuaries use risk management techniques to better understand the risks taken. These practices have been developed over many years, allowing practitioners to make better decisions based on unique risk preferences and exposures. These practices continue to evolve, expanding to consider all risks as well as their interactions and correlations. This article is based on recent research conducted for the SOA Health Section titled Enterprise Risk Management (ERM) Practices as applied to Health Insurers, Self-Insured Plans, and Health Finance Professionals. It can be found at *http://www.soa.org/research/health/hlth-erm-practice-health-insurers.aspx.* The research included a literature search as well as a practitioner survey to determine the current state of ERM within the industry, and made suggestions for future research projects.

Some have complained that ERM allowed the recent financial crisis to occur or that it is just a buzzword for practices already being done. The reality is that ERM does not eliminate risk but helps you to better understand the risks accepted. There will always be people willing to take risks. Many times they do not understand the risks taken or incentives are misaligned. Many examples of both have occurred, but there are also examples of companies that kept debt low and stockpiled cash so they could exploit the underpriced risks offered up when liquidity was in short supply. Risk management balances risks and returns and goes well beyond risk mitigation techniques.

Not Hypothetical in Today's Connected World

An example specific to health insurers may help the reader to better understand ERM's focus on risks to the enterprise that includes risk combinations. In late 2008 publicly traded health insurers found themselves faced with multiple challenges. Few had tested scenarios where all happened at the same time, but this group of risks turned out to be highly correlated. The rapid fall in stock prices led some publicly traded companies to lose more than 50 percent of their market value. Their own balance sheet was hit hard at the same time (including defined benefit pension plans and assets purchased for the surplus account). Financial risks including liquidity, interest rate, and credit risks all saw downside volatility. In addition, many of the companies that health insurers provided coverage for through insurance or servicing self funded plans significantly reduced staff. This decreased the number of covered lives and reduced insurer coverage of fixed expenses. As these risks impacted health insurers at the same time, those with an ERM process in place recognizing the possible occurrence of a combination of emerging risks were better able to anticipate and respond flexibly.

Few sectors have consistently addressed combinations of fundamental or emerging risks. Although some health insurers are moving to this approach now, according to survey respondents few have shown the desire, or ability, to optimize the risk-return relationship across all risks. The survey, and follow-up discussions, showed that company culture has not allowed full program implementation. Truly best practice ERM merges results into incentive compensation across a longer time horizon. To date that is not happening across the industry. This situation may change as existing ERM programs mature and fully implemented programs demonstrate success relative to their peers. Some health insurers have created a Chief Risk Officer position and many have created Risk Committees.

Current and Best Practices

Considering that relatively few health insurers have fully implemented an ERM process, best practices at firms that have done so are quite good. Risks have been catalogued, interactions considered and marginal impacts of decisions tested. Risk culture and board interaction remain an issue even at best practice companies, as is the case with firms in other industries. It remains challenging to get the message heard. An enterprise risk management (ERM) process is an iterative dynamic. The field is evolving as new issues and solutions arise. The recent financial crisis taught many practitioners that an overreliance on quantitative solutions can be problematic. Emerging risks such as global warming and technological advancements are hard to fully anticipate but cause a need for rapid adjustments. Many emerging risks have implications for health insurers. Some

could reduce costs, such as a preventive vaccine for cancer. Others are expected to increase costs, such as an influenza pandemic. Many health insurers are performing the bare minimum ERM duties as they respond to rating agency requests and prioritize the multitude of tasks required in today's complex industry. ERM as practiced by rating agencies continues to evolve, but it clearly is an area to watch going forward as the recent financial crisis has focused rating agency interest on this topic. Communication to external stakeholders must also be improved. Each firm's culture will drive the level of commitment to ERM.

The primary findings of this research project are

1. Health insurers are still getting their hands around what enterprise risk management is. According to survey participants, they practice solid silo risk management but often struggle to implement risk interactions and discuss how risk analysis can be used to make better decisions. Their responses indicate that this is sometimes driven by poorly written but well meaning governmental regulations.
2. Best practice enterprise risk management is a process, evolving iteratively, rather than a one time project. Health companies are at various stages on this continuum. Practices range from doing nothing beyond solid silo risk management to fully implemented plans that collect leading indicators used to make decisions. Few have a fully functioning risk culture that allows challenges of ideas coming from the top of the organizational structure. Better practices are often driven by company size. Larger firms have more resources and other processes are more likely to be relatively sophisticated (e.g., a company with extensive systems capabilities is more likely to practice strong ERM).
3. Most health insurers that have implemented best practice ERM have done so internally with minimal external help.

Some recommendations for future research include exploring correlations between risks, quantification of regulatory risk, emerging risks and asset-liability management projects.

Role of Actuaries in ERM

No one person understands every risk taken by a company. Even if one did, this would lead to a concentration risk around knowledge as the firm relied on a single person. Great ERM, just like great leadership, depends on a risk culture that spreads throughout an organization. ERM leadership requires general risk management knowledge, along with unique industry and company knowledge. A single educational program can't do it all. An effective ERM specialist will likely have a general background regarding risk along with specific expertise tied to the company's primary risks. Actuaries have a broad set of skills that make it appropriate for them to take a seat at the ERM table and be considered to head this team. As with any senior management position, soft skills involving communication and management are required. Few others have been exposed to assets, liabilities, pricing, underwriting and strategic planning. Especially if a company is optimizing the risk/return relationship versus undertaking a perfunctory checklist exercise of basic operational risks, the actuarial skill set can help a company meet its goals.

Some health practitioners currently hold the Chief Risk Officer title and 35 have earned the CERA (Chartered Enterprise Risk Analyst) designation. The actuarial profession must bring both technical expertise and strong communication skills to take a lead role in ERM efforts. The topic is positioned for growth. Actuaries must reach out to add value by understanding interactions between risks and tools to look at risks both qualitatively and quantitatively. Risk is Opportunity! ■