Society of Actuaries

2014 Enterprise Risk Management Symposium

Sept. 29 - Oct. 1, 2014, Chicago, IL

Enterprise Risk Management and Diversification Effects for Property and Casualty Insurance Companies

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Abstract

In a well-designed enterprise risk management (ERM) program, the firm integrates risk management into the strategic planning process, addressing strategic risk, financial risk, operational risk, and hazard risk under a single overarching process. This is particularly important to large financial firms, such as property and casualty (P&C) insurers, which face a diverse set of risks. We find that ERM quality, as measured by S&P ERM ratings from 2006 - 2012, has a strong positive affect on ROA and Tobin's Q for P&C insurers. In contrast to previous studies that have found that diversified firms suffer a value discount relative to their more focused peers, the results of this study suggest that, after controlling for ERM quality, business line diversification is associated with a performance premium whereas geographic diversification is not a significant factor.

Keywords: Enterprise Risk Management (ERM), Diversification Effect, Property and Casualty, Insurance Company Performance

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