

# Does ERM matter?\*

## Enterprise risk management for the insurance industry

A global study – June 2008





## ERM: the past .....

In 2004, PricewaterhouseCoopers asked insurers about their ERM functions\*. At that time, ERM was a new discipline recognised as the key to managing uncertainty, top-line results were telling:

**18%**

strongly agreed that ERM was an important part of their interaction with regulators, rating agencies and investor constituents

**19%**

strongly agreed that their organisation had clearly defined standards for risk taking activities

**10%**

had a risk function in place for at least three years

\* PricewaterhouseCoopers Global ERM Survey 2004



## ERM: the present .....

Now, insurance **industry stakeholders** are shaping attitudes to risk management in ways not seen before:

Solvency II is a fine example of **regulators** overhauling prudential supervision

**Ratings agencies** are introducing ERM assessment into the ratings process.

The importance of ERM is shifting at speed and the quality of a firm's ERM framework will become one of the factors which will impact the cost of capital.



## ERM: the present .....

How far we have come:

**58%**

strongly agreed that ERM was an important part of their interaction with regulators, rating agencies and investor constituents

**35%**

strongly agreed that their organisation had clearly defined standards for risk taking activities

**50%**

had a risk function in place for at least three years

# ERM: the present .....

How far we have come:

2004  2008

7%	Clear vision and goals established for ERM and business units are involved in defining the risk management initiatives	31%
16%	ERM governance structure is in place and is proactively being managed (e.g. enterprise risk committee)	44%
20%	The ERM unit is responsible for setting firm wide standards for risk management	37%
52%	Communication of risk management across the organisation is effective	73%
31%	CRO has primary responsibility for designing and monitoring ERM	60%

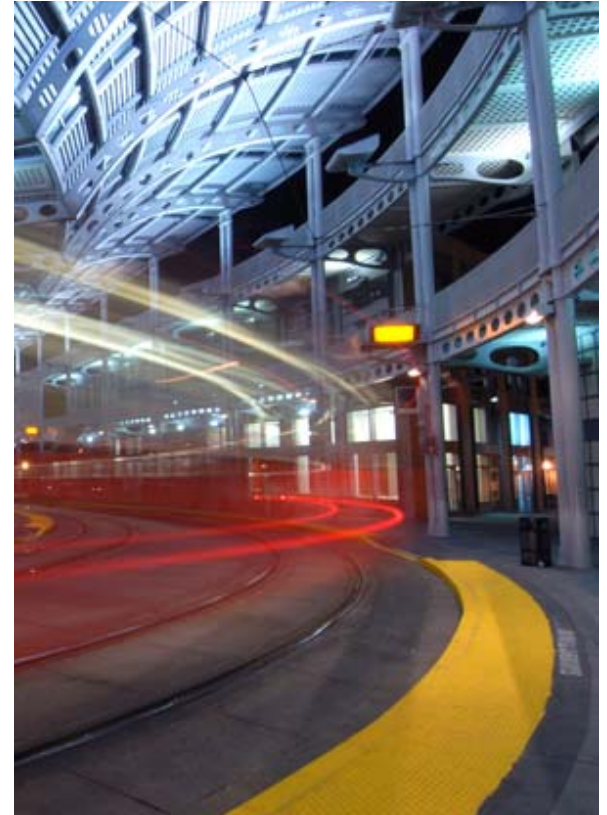
# ERM: 2008 Highlights

## ERM has made significant inroads at the top

More than 90% of insurers have ERM programs in place, and ERM is a Board priority across the industry.

Some 40% of respondents say their firm has a Board-level ERM committee, and nearly a quarter are considering establishing one.

Chief risk officers are gaining in stature: In about 60% of the firms, the CRO communicates directly with the Board on at least some risk management issues.



# ERM: 2008 Highlights

## **ERM's integration into risk decision-making is limited**

Despite progress at the top, firm-wide understanding of ERM typically remains limited, potentially undermining its actual use in business.

Most insurers are at least “fairly confident” (and 44% are “very confident”) that they have clearly defined their risk appetite, but the alignment of risk appetite and key business decisions is often limited.

Fewer than half of respondents are confident that ERM is genuinely embedded in their firm's strategic planning, resource allocation and performance management functions. (Compares to just 4% in 2004).

Three-quarters of firms have business units that do not base their risk tolerances on the risk appetite and tolerance levels set by senior management.

Underwriting profitability – not any measurement of risk – remains the most important factor in setting risk limits for personal and commercial lines.

# ERM: 2008 Highlights

## **ERM effectiveness is often hindered by poor risk information**

The quality of risk data and usability of analytical models needed for ERM have a long way to go. Insurers are investing in modeling and greater use of analyses into strategic planning, along with the development and refinement of risk governance, monitoring and reporting.

The risk assessment tools and methodologies needed for ERM are up and running in only about half of firms, and only a third of respondents say that the management of operational risk is well-embedded in their firm's day-to-day processes.

Fewer than 40% of respondents believe their firm's risk data and systems are "good" or "excellent," only a marginal improvement from 2004.

ERM analysis requires credible data and a reliable infrastructure – but nearly 60% of respondents believe that the control environment surrounding model data input in their firm is of "moderate" or "weak" quality.

# ERM: 2008 Highlights

## **Many firms are still grappling with developing effective ERM governance**

Survey respondents believe that roles and responsibilities in their ERM program are less than clear and that interaction between the risk team and line business units is too limited.

Only a quarter of respondents believe that their ERM program is sufficiently proactive within their company, despite this having been a key objective of respondents to the 2004 survey.

Just a third of respondents are “fully confident” that their firms have clearly-defined roles, responsibilities and accountability for ERM, up only slightly from 31% in 2004’s survey.

While training is essential in developing understanding within the wider business, fewer than 20% of respondents say their firm has established and effective risk management training programs.

# ERM: 2008 Highlights

## Poor use of ERM to control risks and realize opportunities

The insurance industry faces issues including a softening of non-life premium rates, heightened capital constraints, increasingly complex products and pressure to expand into new markets – but firms are not using ERM effectively to manage either emerging risks or new opportunities.

While nearly 70% of insurers have a process to identify emerging risks, fewer than half of the respondents are “quite confident” – and only 4% are “fully confident” – that it is functioning effectively.

Only 20% of firms make full use of “risk learning” initiatives to deliver immediate feedback on emerging risks and trends and reflect this into pricing and model assumptions.

Only 10% of firms have a process to align their assessment of new opportunities with their risk appetite; more than a third do not use risk/reward considerations in making decisions about whether to seize opportunities.

# ERM: 2008 Highlights

## The industry recognizes the need for further development of ERM programs

Many insurers recognize the need for further development of their ERM programs. Yet effective ERM cannot be imposed from the top: Business lines need to believe that it can help them to make more informed decisions. Survey respondents are identifying improvements that add value to daily operations.

Nearly half of firms plan to improve their asset liability management metrics in the coming year and another 30% plan to do so in the next one to three years.

More than a third of the firms plan to develop their risk indicators and loss event database for operational risk.



# ERM: 2008 Highlights

## Insurers have made strong progress in the

- status and mandates of the CRO and Risk Organization.
- definition of respondents' overall risk appetite.

# ERM: 2008 Highlights

## Insurers have made some progress in

- the linkage of strategic planning and ongoing business planning (the improvements noted were very mixed across the respondents)
- the establishment of a risk framework, which has facilitated an initial development of a portfolio view of risk .... participants noted objectives to strengthen risk self-assessments and risk aggregation capabilities, which will in turn improve the portfolio view of risks
- modeling and modeling capabilities, both by major risk category and overall capital modeling:
  - increasing reliance on modeling and for decisions relating to M&A, capital actions, product development and pricing and diversification (but it does take time for the business to understand and accept model results, particularly as it relates to insurance risk and capital modeling)
  - participants are very focused on the responsibility of model outputs - most indicated a need to significantly strengthen their model control and validation frameworks

# ERM: 2008 Highlights

## Insurers have made limited progress in

- the clarity of roles and responsibilities, as it relates to leveraging existing risk management activities by the risk takers in the business
- the clear linkage of the overall risk appetite to discrete risk tolerances and limits by major risk category and business
- limit monitoring, escalation and enforcement.
- the development of KRIs and Board reporting ... however, progress was planned on both fronts
- the integration of self-assessment activities across risk and compliance, including internal policy and regulatory compliance and audit ... this is surprising given the high demand for such integration by business leaders, and in our experience, progress in this area is often related to having the appropriate sponsorship for the initiative

# ERM: 2008 Highlights

## In summary

- this survey reveals strong progress overall
- the pace of progress is not a surprise to us, given that ERM is a relatively new management discipline for insurers and it takes time to develop new management discipline
- the survey results indicate a commitment to foster development of ERM practices, and key indicators include:
  - taking a more proactive stance around identifying opportunities as well as risks
  - increased consideration of models in key decisions.
  - clearer linkage of overall risk appetite and discrete risk limit self-assessment processes, and the development of key risk indicators.
- insurers self assessment results track closely with a recent analysis by a leading rating agency – this indicates insurers are generally realistic about where further work may be required and is evidence of their commitment to the continued development of their ERM programs

# ERM: Contact us

PricewaterhouseCoopers is delighted to work closely with insurers and to commitment to research, debate and develop risk management best practice.

For more information, please contact your local PricewaterhouseCoopers representative or contact a risk specialist:

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# ERM: 2008 Highlights



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