

ERM Rules

Actuaries advise life insurers to follow these steps as they build enterprise risk management programs.

by R. Dale Hall

Doing business during this Sarbanes-Oxley-compliant, post-9/11 era is challenging and what you don't know can hurt you. Enterprise risk management—better known as ERM—has become more than just a buzzword.

Boards of directors and senior management teams pay close attention to ERM because of ratings agency requirements, globalization and an expanding breadth of risks.

To get a clearer picture of their potential risks, life insurers should ask these questions:

- Are past mitigation efforts truly making a dent in the ever increasing number of risks?
- Is my company prepared for risks looming on the horizon?
- How is stakeholder value being protected?

Balance is essential in managing and capitalizing risks to appropriate levels. Otherwise, there is a risk of over-mitigating or underestimating exposures. The goal is to build an ERM framework from the ground up. This process enhances rating agency discussions on ERM, validates recent risk mitigation decisions and applies this framework forward to other insurance and financial service businesses.

Recognizing that businesses are failing to deliver on the promise of ERM, leading actuaries within the field, in partnership with the Society of Actuaries, recently developed five guiding principles that companies can use to build and maintain an enter-

prisewide risk management program.

ERM must be a continuous process, not just a tool to bring the company up to speed for the time being. That's why it is so important for experts managing the ERM process to be on track from the beginning and spread this knowledge throughout the company.

For an ERM program to deliver all its potential benefits, the SOA recommends that companies take the following steps:

1. Select a qualified leader. To develop an ERM program, and to lead this effort, many companies turn to the actuarial profession due to its rigorous training in predictive modeling and the ability to forecast emerging risks. The experts can then work with senior financial staff, life operations senior management, corporate management and the disaster recovery team, to establish a strong framework and knowledge base.

2. Establish clear communication. It's important that business units and senior leadership talk to each other frequently. Many chief financial officers have taken a lead role in communicating regularly with board members about the importance of ERM and the plan's structure. Senior management's support has proven vital to having the plan incorporated throughout the company's infrastructure.

Effective ERM requires the translation of highly complex, technical data into digestible and actionable information. This principle relies on the immersion of ERM into the company's corporate culture. ERM must not be just a phase, but an integral and easily understood part of the decision-making process.

3. Combine qualitative and quantitative information. This is often an overlooked part of the risk management process. It is difficult to quantify certain risks, such as brand

reputation, and the importance of employees and agents to the company. However, through actuarial modeling, the risk management teams can quantify the worst-case scenarios involving operational and reputational risks.

Teams may determine through risk analysis that a pandemic, an attack on the computer network, catastrophic claims events and issues with non-guaranteed insurance elements would cause the largest decrease in a company's enterprise value.

Putting a quantitative number to these previously unknown levels of risk can be a major step in calculating the company's enterprise value and the impact that severe perils could have on stakeholder value. As a result, many companies develop new processes to manage pandemics and catastrophes. They also can perform exercises to gauge the company's preparedness.

4. Establish a broader focus. This includes looking at risk not as just a financial loss, but also as an interconnected risk involving operations and the company's reputation. By involving a wide range of expertise from throughout the enterprise, companies can tap into the knowledge base of employees to help keep major risks in check.

5. Get an attitude adjustment. Companies can change by developing and implementing a solid ERM program. But only by earning support from agents, employees, board directors and senior management can the company build a lasting value of ERM into its corporate culture.

An ERM framework can help determine the overall risk tolerance for senior leaders as they make strategic decisions to manage tomorrow's risks. Keep in mind the importance of knowing the unknown. What you know can help you. **ER**

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