CRO Forum

Milliman Ireland

Eamonn Phelan
Padraic O'Malley
Ger Bradley

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Oxford Economics – Milliman

Survey – 2014 – North American Risk Executives

- Key aims to assess
- *"Understanding how ERM activities translate into business value"*
- *"Support and enhance returns"*
- *"Translation of risk to financial and capital goals"*

Plan for this Morning

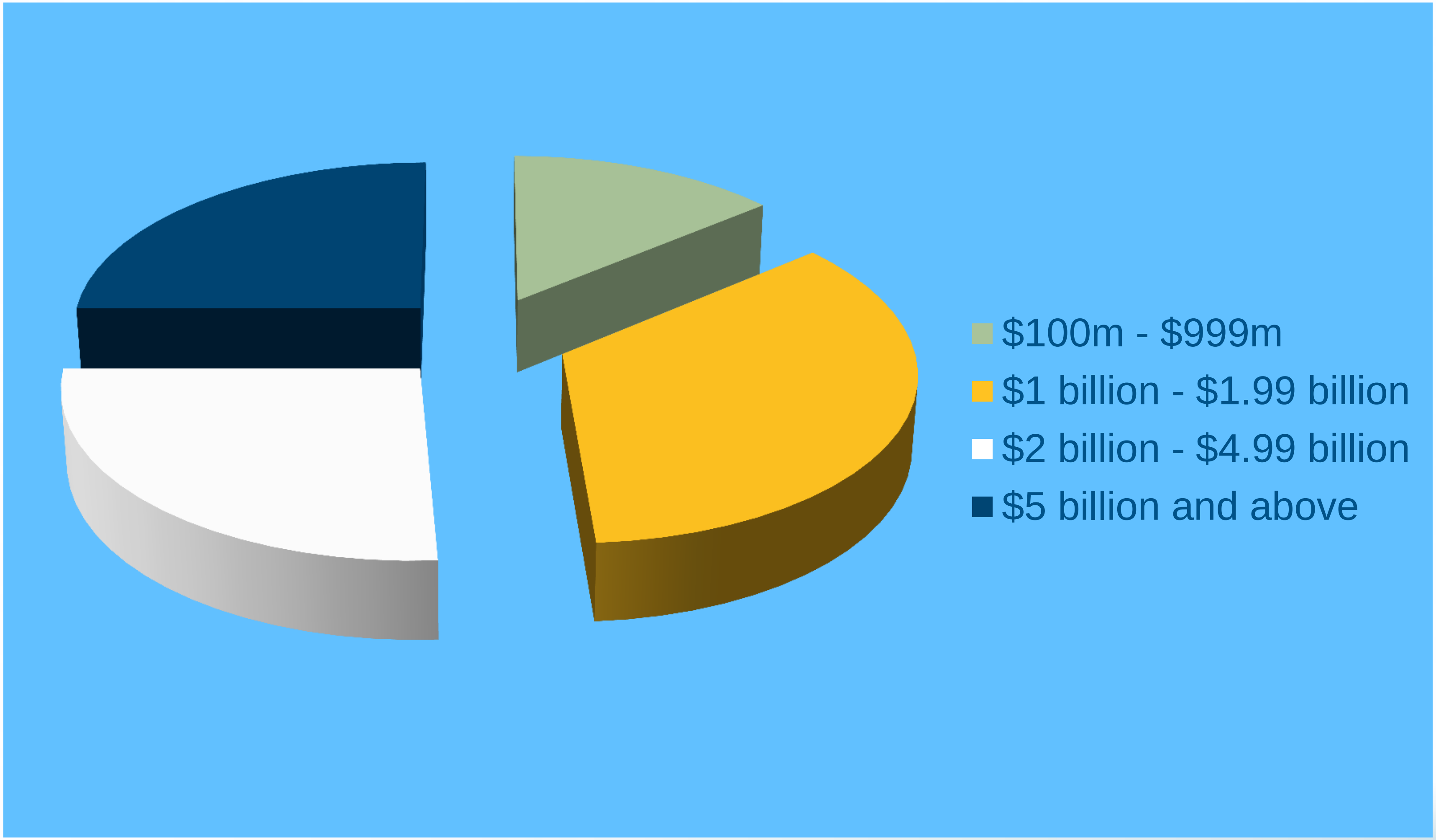
- *Provide Overview of Survey*
- *Have discussion around key areas for CRO in ERM*

What is ERM?

- James Lam
- ERM is a three part process

1. ERM must address the core risks facing the organisation – including strategic risks, operational risks and financial risks.
2. ERM must encompass the key levers of risk governance and policies, risk analytics, risk return optimisation and monitoring and reporting.
3. ERM must consider aggregate exposures and risk interdependencies across the organisation’s risk portfolio

What is your revenue?



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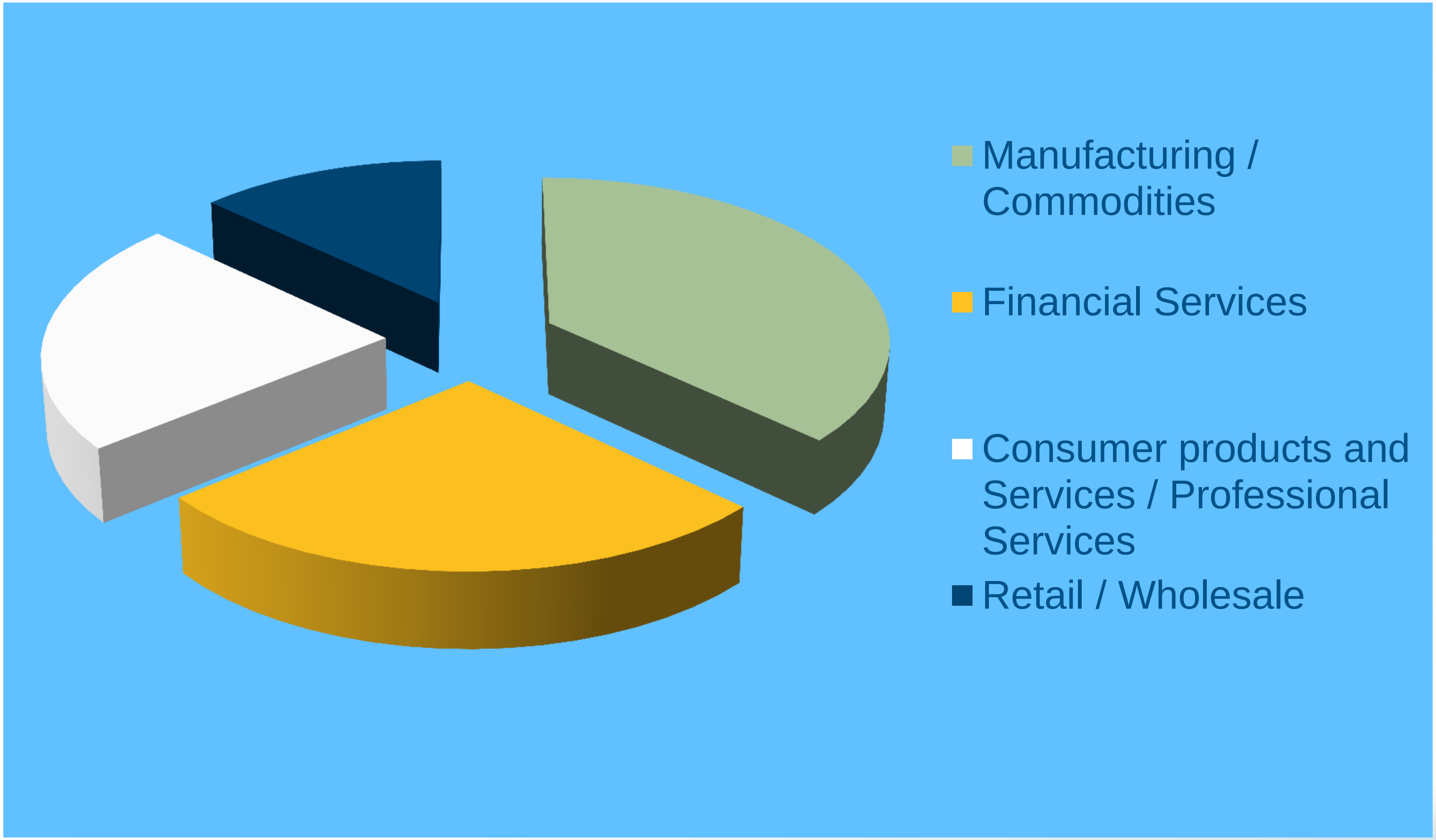
What is your Industry?



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Measured across eight attributes

- Embedding ERM in Strategic Planning
- Implementing a pro-active and forward looking risk strategy
- Maintaining timely high quality data related to risk
- Linking corporate and business unit level risk tolerances
- Giving ERM a strong role in the budgeting process
- Creating more data-driven ERM
- Collaborating closely with Internal Audit
- Integrating compliance across the organisation

Trendsetters?

- 13% of respondents; Over 2/3rds are financial services firms; Over 2/3rds report over $2 billion in total revenues
- Far more likely to have a CRO (75% vs 44%)
- No-one had fully embedded ERM into strategic planning and budgeting
- No single method of measuring cost benefit of ERM emerged
- Use of Risk Appetites almost universal (81%)
- Critically concerned by new legal and regulatory requirements (75%); by contrast no risk category was cited by more than 40% of the beginners and transitionals

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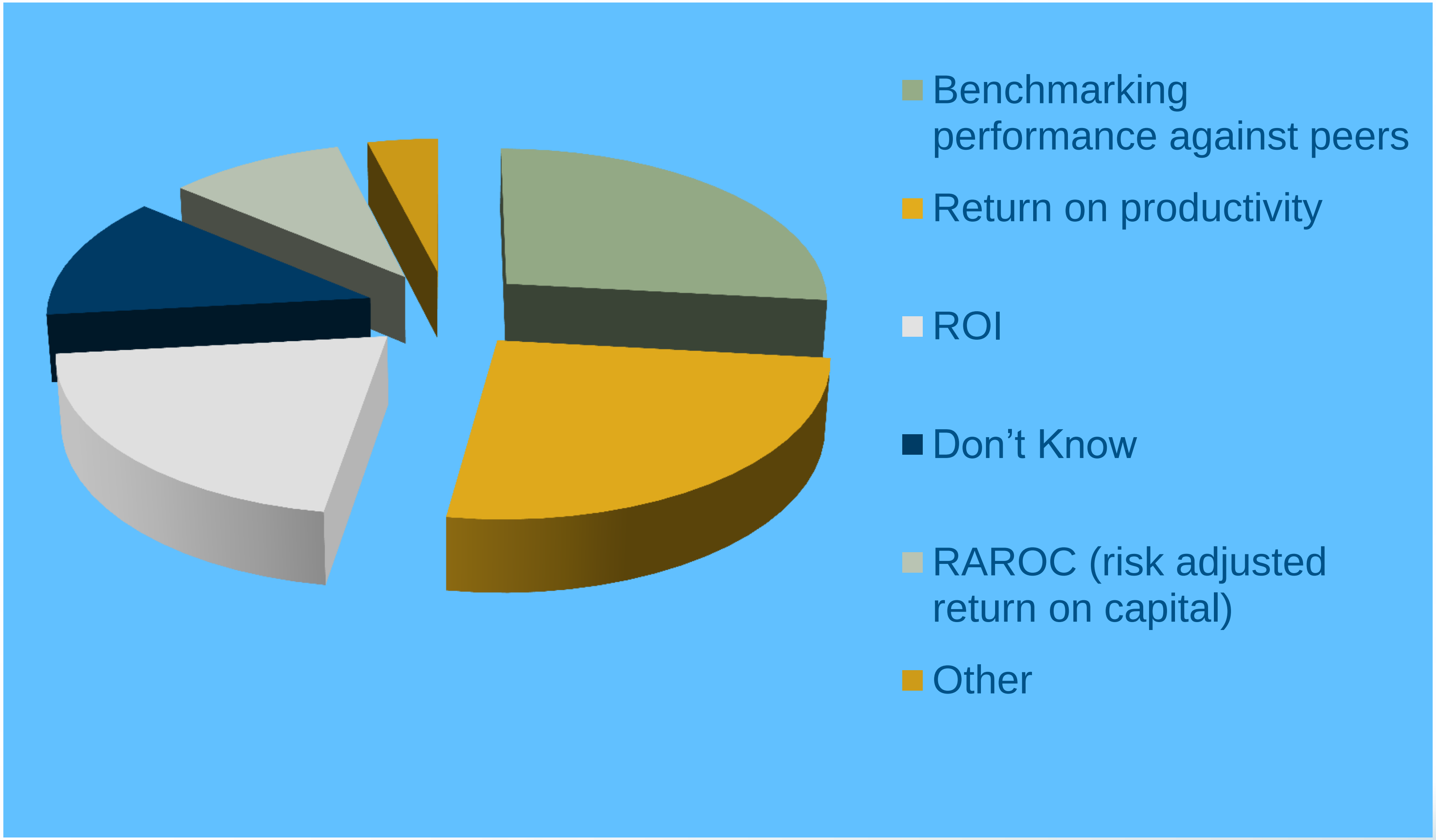
How do you calculate the cost benefit of ERM?



Most important challenges in measuring ERM for trendsetters

- Difficulty deciding on a metric
- Difficulty assessing the likelihood of a breach occurring
- Incomplete consolidation of risk system across organisation
- Flaws in modelling data
- Difficulty in estimating cost of potential risk events

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Measured across eight attributes

- Brian Merkley, Huntsman Corporation:

- *"If you ask 100 people what is your risk appetite for a particular risk, you might get 100 different answers. So it gets tough to pull that together into one meaningful consensus statement."*

How did our respondents extract value from ERM?

TRENDSETTERS FAR MORE LIKELY TO GET VALUE FROM ERM IN THE FOLLOWING WAYS:

- Enhanced Board oversight
- Higher quality strategic planning
- Better capital efficiency
- Improved performance management
- Stronger brand reputation

How did our trendsetters turn more efficient ERM into greater success and value creation?

THEY TYPICALLY FOLLOW THE FOLLOWING SIX BEST PRACTICES

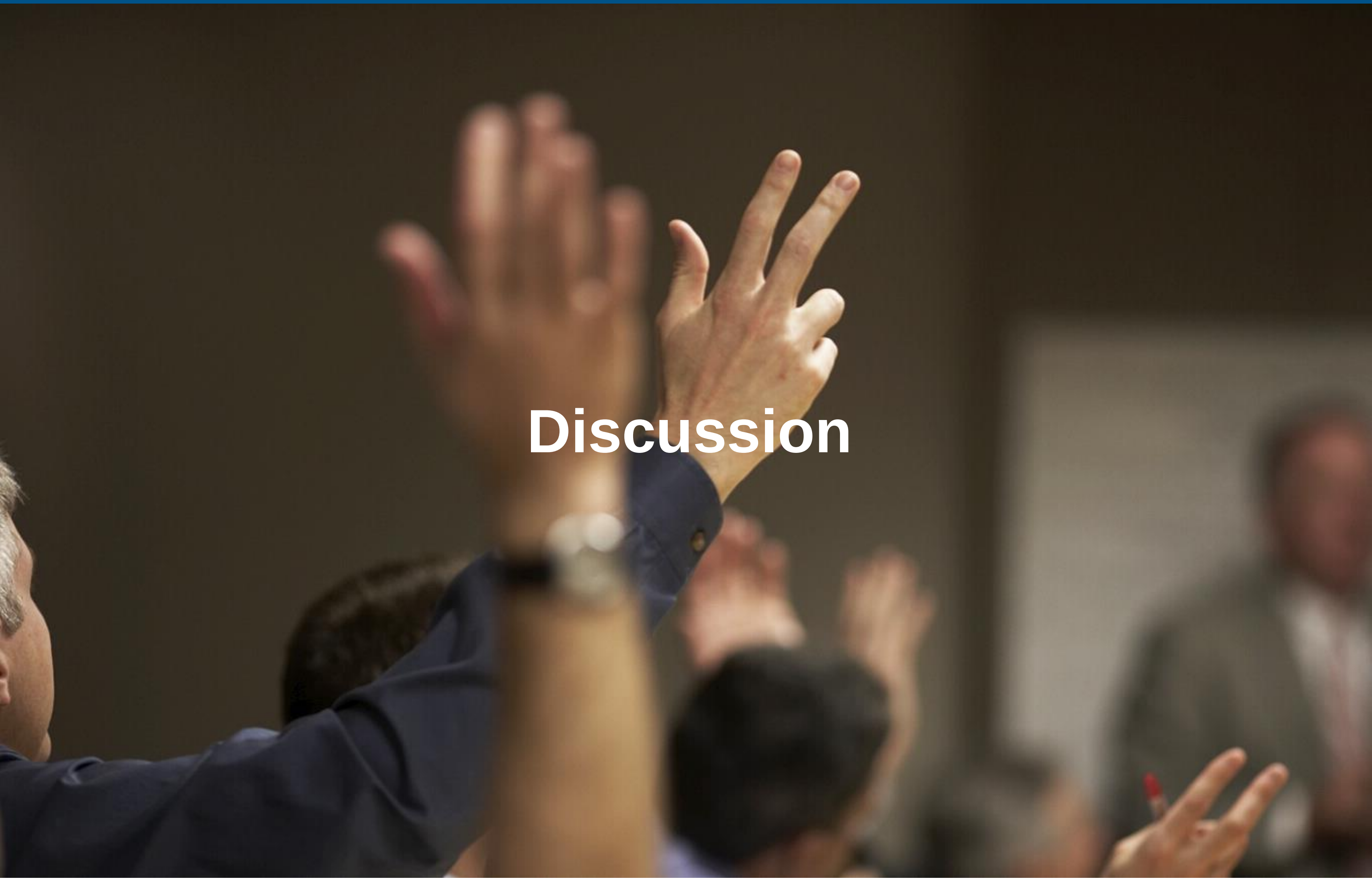
- Closer Collaboration with Senior Management
- Better use of Risk Appetite Statements
- Linking risk tolerances at the corporate and business-unit levels
- Advanced tools and methodologies
- More frequent ERM audits
- Taking a more pro-active approach

Action items for better ERM value creation

OUR CONCLUSIONS

- Go back to basics –
  - Get the ERM metrics right
  - Upgrade quantitative tools for analysing and managing risk
- Give ERM a stronger role in budgeting and capital allocation
- Integrate ERM with performance management
- Make third party and supply chain risk a priority

Discussion



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Six Areas for Discussion

1. Risk Adjusted Measures
2. Capital Allocation
3. CRO of Subsidiary?
4. Performance Management
5. Solvency II Impact
6. Third Parties

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Discussion Area 1- Risk Adjusted Measures

- Does your company use a risk-adjusted performance measure?
  - Risk adjusted return on capital?
  - Risk adjusted return on risk adjusted capital?
  - Normalised?
  - Something else?
  - Plan to move to such measures?

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Discussion Area 2- Capital Allocation

- Does your company allocate capital across lines of business or business units?
  - Do you allow for diversification benefit?
  - How do you allocate diversification benefit?
    - Pro rata simple
    - Pro-rate marginal
    - Monte Carlo
    - Euler method
  - Purpose
    - Pricing
    - Performance Measurement
    - Remuneration

Discussion Area 3 - Subsidiary CRO

- More difficult for subsidiary CRO to influence strategic decisions?
  - Does this change the focus for the subsidiary CRO?
  - How best to add value in such a role?
  - Can FLAOR and/or risk appetite be used to add value – feedback from local Board?
  - How to think about risk in appropriate way?

Discussion Area 4 – Performance Management

- Is remuneration in your company linked to risk adjusted measures?
  - Deferred remuneration?
  - What is the CRO role in relation to remuneration?
  - To what levels does this apply?
- Solvency II deferral requirements
  - Substantial portion of variable remuneration shall contain a flexible, deferred component
  - Deferral period of not less than three years
- Have you agreed (or better still implemented) your approach for SII?

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Discussion Area 5 – Solvency II Impact

- Assist company in making business changes:
  - Investment policy
  - Reinsurance strategy
  - Unit-linked matching
  - Pricing
- Has your company transitioned such items?
  - Do you have a plan as to when you will do so?

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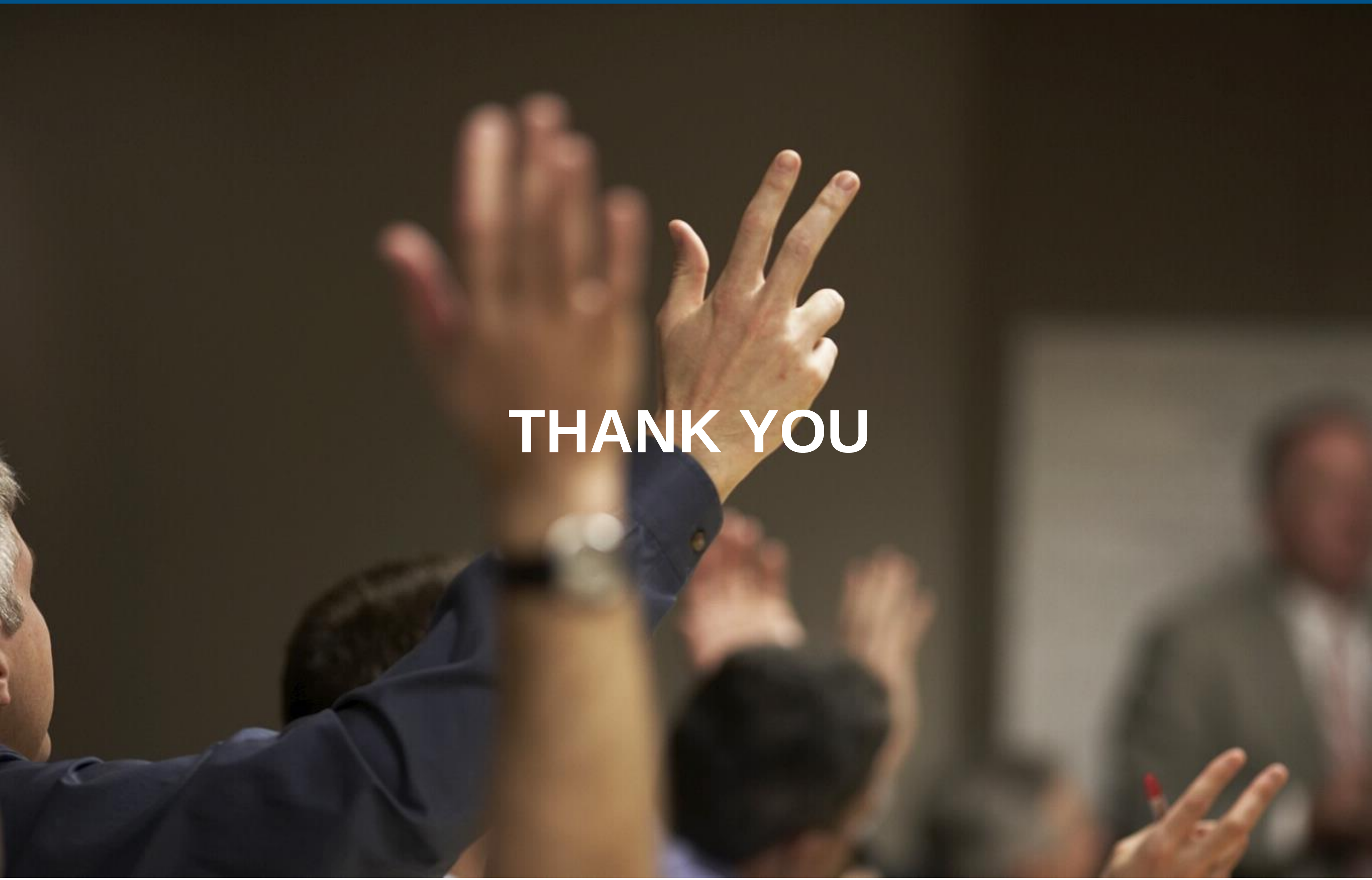
Discussion Area 6 – Third Parties

- Third party risk fully addressed?
  - Distribution
  - Asset managers
  - Claims handling companies / Expenses (non-life)
  - Others



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