

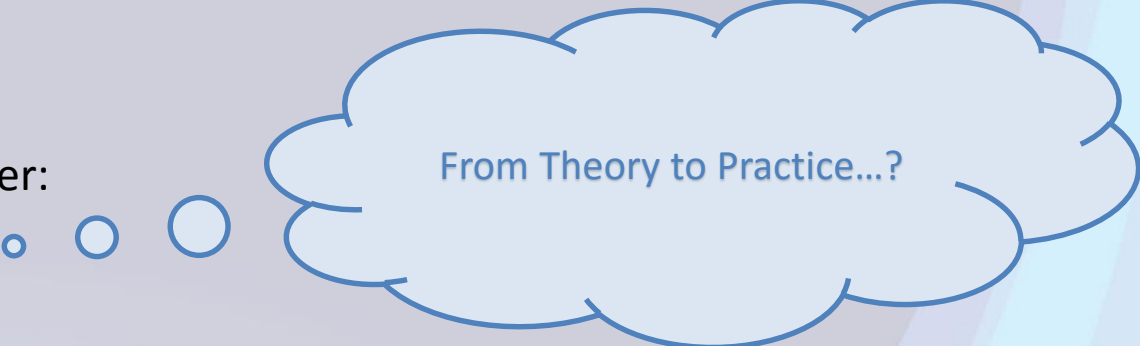
# **Risk Management: From Theory to Practice**

## **Presentation to Insurance Ireland**

22<sup>nd</sup> November 2017

# Putting Risk Management into Practice

Views on Risk Management as Gamekeeper turned Poacher:

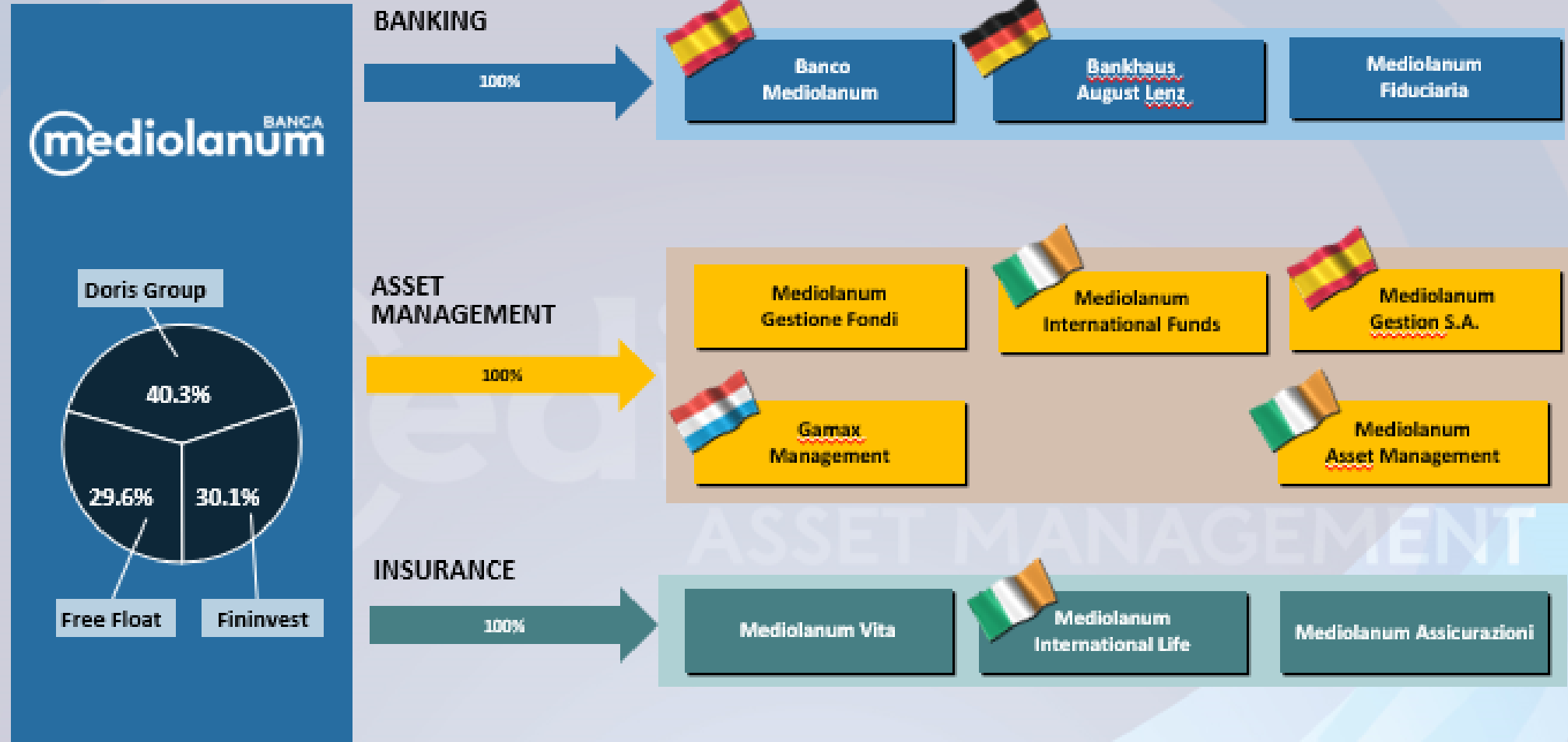


From Theory to Practice...?

The core principles remain the same:

- Supervisory perspective:
  - Risk Framework must capture the key risks
  - Be embedded in the business
  - Be used by the business
  - Be part of the DNA of the firm
- Putting Theory into Practice:
  - Careful design and implementation of the Risk Framework can achieve the above
  - It's all too easy to design the framework with the Regulator in mind
  - Instead, think about the business activity being performed rather than Risk per se...
  - Guide the business to design something that works for them
  - [This tends to be easier for P&C/Reinsurance business and in asset management also]

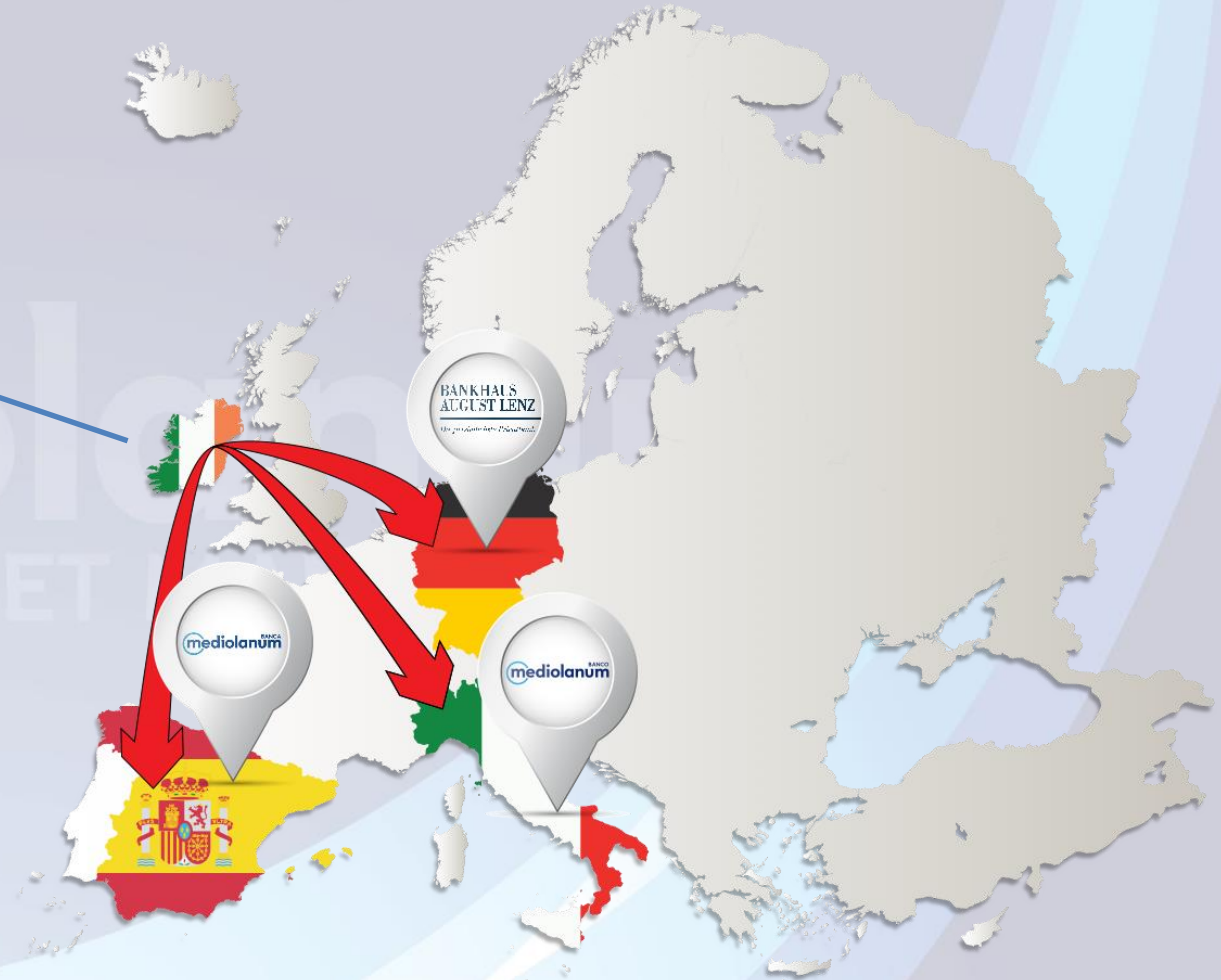
# Overview of Mediolanum Group



# Mediolanum Irish Operations

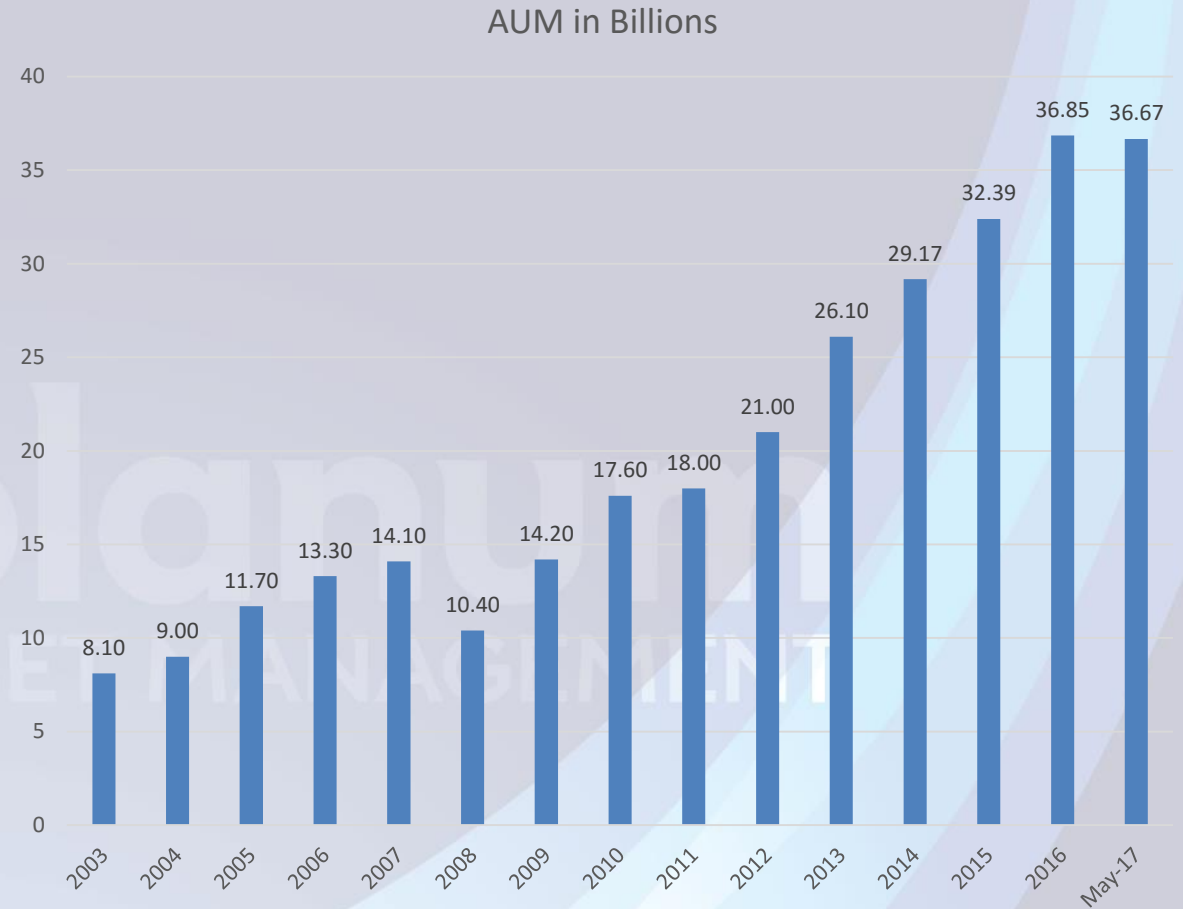


- MAML: Asset Management arm of the Group
- MIFL: UCITS/AIFM ManCo: manages UCITS and Non-UCITS funds. Investment product innovation centre, and the investment solutions research and development hub, for the Group
- MIL dac: Niche Life Assurance provider for the Group.



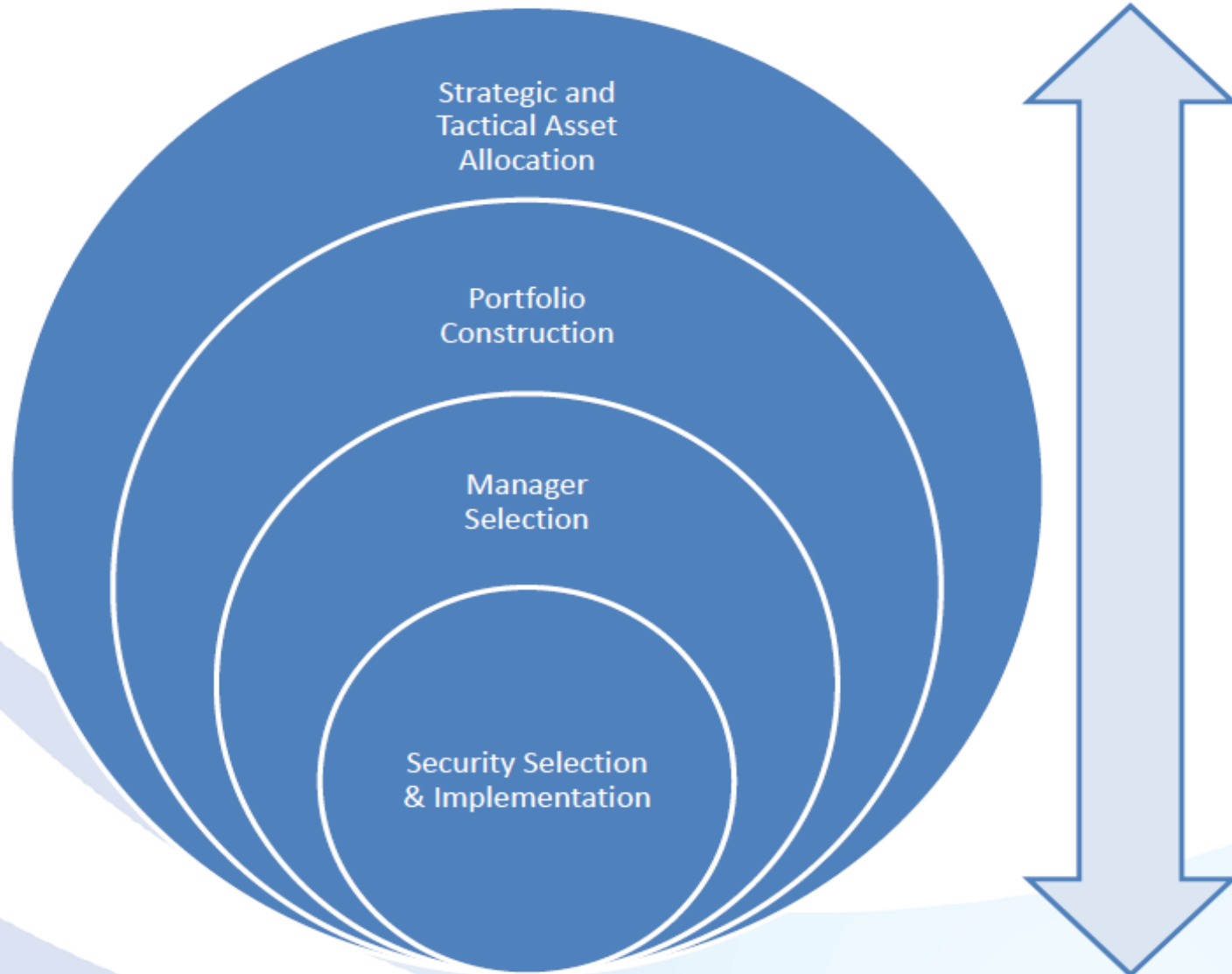
# Mediolanum Irish Operations

- Staff compliment of c.100
- Products distributed to Italy, Germany & Spain
- Investor base is mass affluent retail investors
- Tied Agency network in each market with 4,500 agents across Italy alone.
- AuM in excess of €36bn
- 70 funds (UCITS or AIF) covering all regions, sectors and asset classes
- Core Competencies:
  - Product Development
  - Asset Management/ Portfolio Management



\*Source: Mediolanum International Funds Ltd, Data as 31<sup>st</sup> of May 2017.

# Mediolanum Irish Operations: Core Competencies



## Product Development

The Mediolanum Product Development Process, 'MedInSynC', is a core Mediolanum process, focused on:

- Client centricity;
- Investment quality; and
- Excellence in execution.

## Investment Management

Funds managed using proprietary Med<sup>3</sup>® Investment Process

Alpha generation through numerous sources, including:

- Strategic Asset Allocation
- Manager Selection
- Portfolio Construction
- Specialist Security Selection

# Mediolanum Risk Management Framework

- Largest single risk on the Risk Appetite Statement is Business Model risk
- Key building block of success of business strategy rests on the continued delivery of superior client outcomes through our Asset Management activity
- Singular focus across the business in delivering Attractive, Risk Adjusted Returns
- The most significant allocation of 'Capital' is to the investment activity
- The adherence to and efficacy of the Investment Process is critical
- Risk naturally focuses on Investment Risk Governance as a consequence
- This also requires a review of the process to reduce, mitigate or eliminate behavioural biases which may be prevalent in investment decision making

# Investment Risk Governance as a key Enabler

Core Competency / Intellectual Capital lies in the Investment Process

Enhanced Investment Risk Governance is utilised as a key enabler of the Investment Process.

- Observations from behavioural finance are in-built into the Framework so that decision making is cognitively optimised:
  - Make more 'skill-driven' decisions and fewer decisions left to the mercy of luck;
  - Identify those scenarios or conditions in which good or bad decisions are likely to be made; and
  - Channel emotions more effectively, either checking or exploiting them, as appropriate.
- The Risk Function plays a central role in safeguarding the integrity of the investment process.
- A key part of this is understanding how common behavioural biases can manifest themselves and build in appropriate safeguards at all stages in the process.





# Common Behavioural Bias Groups

## Example 1 : Predicting the Future

When we have a good year, somehow we assume that we will always have money.

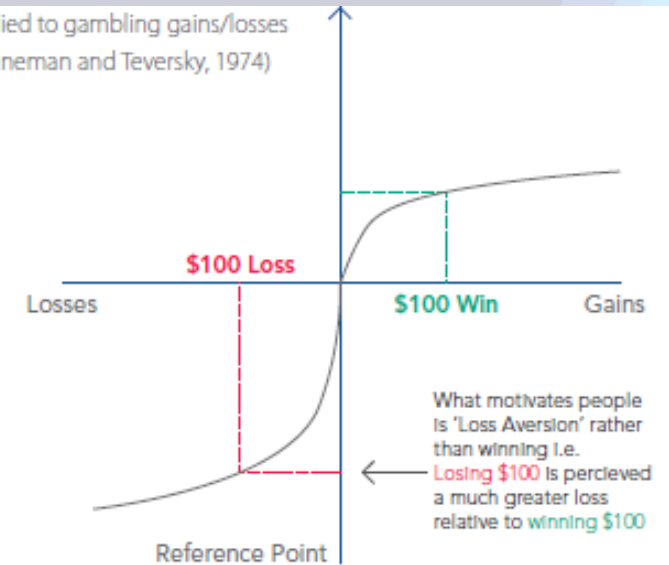


- Projection Bias
- Recency Bias
- The Snake Bite Effect

## Example 2: Fearing Loss

People dislike losses on average 2 to 2.5 times as much as they enjoy gains.

applied to gambling gains/losses  
(Kahneman and Tversky, 1974)



- Loss Aversion
- Prospect Theory
- Disposition Effect

# Behavioural Bias Library

Bias	Description
<b>Outcome Bias</b>	Evaluating the quality of a decision when the outcome of that decision is already known.
<b>Herding</b>	Individuals follow the crowd for fear of missing out
<b>Confirmation bias</b>	Seeking new information that confirms existing view
<b>Framing effect</b>	People react differently to a choice depending how it is presented.
<b>Curse of knowledge</b>	When individuals are unable to ignore the knowledge they already have that others don't or they are unable to disregard information already processed
<b>Bandwagon Effect</b>	The rate of uptake of beliefs, ideas, fads and trends increases the more that they have already been adopted by others.
<b>Anchoring</b>	Tendency to rely too heavily on the first piece of information collected when making decisions
<b>Optimism bias</b>	A person believes they are less at risk of experiencing a negative event than others.
<b>Loss aversion</b>	People strongly prefer avoiding losses than acquiring gains On
<b>Disposition effect</b>	Investors tend to sell winners and hold losers
<b>Recency bias</b>	People more easily remember and are influenced by something which happened recently
<b>Information bias</b>	Believing that the more information that can be acquired to make a decision, the better, even if that extra information is irrelevant for the decision.

# Investment Risk Governance as a key Enabler

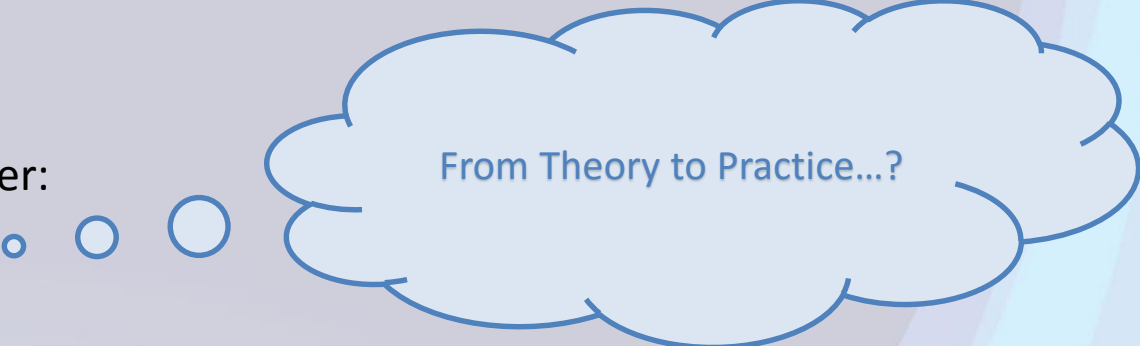
Establish the role of Process Engineer to safeguard the integrity of the investment process

Key Elements include:

- Alpha Capture Model
- Data Collection on Investment Decision Making
- Use of Checklists and Documented Procedures
- Build Cognitive Diversity
- Data Driven Feedback Loop
- Behavioural Biases
- Cognitive optimisation of Process



# Concluding Remarks



From Theory to Practice...?

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