The role of the Chief Risk Officer for actuaries

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Agenda

1. Background

2. The role of the CRO

3. The world we live in

4. The task team

5. What does this mean for actuaries?
Background

- First official record of a CRO: 1993 GE Capital – James Lam
  - Before dot-com, Nick Leeson/ Barings, Enron, Worldcom, Tyco
  - Long before recent crises
- A response to amplified SYSTEMIC RISKS
- A response to demands for IMPROVED RISK MANAGEMENT and GOVERNANCE
- COMPLEXITY OF RISK ENVIRONMENT, and COMPLIANCE
- Remit of risk managers expanded out of Financial Risks

“...the board and board risk committee should be supported by a CRO with clear enterprise-wide authority and independence, with tenure and remuneration determined by the board.”

Walker review, 2009
The role of the CRO

“In essence, the obligation of the board in respect of risk should be to ensure that risks are promptly identified and assessed; that risks are effectively controlled; that strategy is informed by and aligned with the board’s risk appetite; and that a supportive risk culture is appropriately embedded so that all employees are alert to the wider impact on the whole organisation of their actions and decisions.”

Walker Review, 2009
The role of the CRO – Why?

- Expanded coverage of risks
- Enable better investment decisions
- Better standards of governance
- Reducing losses
- Optimise risk systems/processes
- Reduce costs
- Increase trust between owners and agents
- Increase trust between business and customers

**EIU** - “THE EVOLVING ROLE OF THE CRO”, MAY 2005
The role of the CRO – according to IAA

- Policy guidance and minimum standards for ERM
- Oversight of risk management activities
- Lead the risk committee
- Functional leadership of risk personnel
- Monitoring leading practice trends, research
- Challenge BU decisions
- Consult with BU leadership as required

IAA – “NOTE ON ENTERPRISE RISK MANAGEMENT FOR CAPITAL AND SOLVENCY PURPOSES IN THE INSURANCE INDUSTRY”, MARCH 2009
The role of the CRO – Broad vision

- **Probabi**lity
  - Down side
  - **Earnings Distribution**
  - **Risk Appetite**
  - Up side

- **Expected Value**
- **Rand Value**

CRO should actively consider entire distribution
The role of the CRO - Obstacles

- IT challenges related to risk systems
- Measuring operational risk
- Global operations difficulties
- Lack of data
- Keeping up with regulatory change
- Risks posed by external business partners
- Implementing new risk policies among employees
- Board support

EIU - “THE EVOLVING ROLE OF THE CRO”, MAY 2005
The role of the CRO – Expectations

Policy and strategy
- Risk appetite
- Functional leadership
- Stakeholders

Formal
- Reporting and communication

Skills
- Independent thinker
- Influence & Presence
- Technical skill & knowledge
- Operational knowledge
- Talent Ability to anticipate

Influence & Presence
“There is nothing normal about recent deviations in financial markets. The race to zero may have contributed to those abnormalities, adding liquidity during a monsoon and absorbing it during a drought. This fattens tail risk.” – Andrew Haldane, The race to zero
The world we live in – Global risks
The world we live in – Global risks
The world we live in – Global risks

“The world is in no position to face major, new shocks. The financial crisis has reduced global economic resilience, while increasing geopolitical tension and heightened social concerns suggest that both governments and societies are less able than ever to cope with global challenges. Yet, as this report shows, we face ever-greater concerns regarding global risks, the prospect of rapid contagion through increasingly connected systems, and the threat of disastrous impacts.”

World Economic Forum – Global Risks 2011
“The regulatory burden on small banks in the U.S.A. is overwhelming. Current returns on equity look unsustainable.”

“…regulatory pressures were the main drivers for banks to change their business models. The need to focus on financial regulation, to work closely with regulators and to be responsive to new regulations and laws … is now critical.”

“ The key constraint on us is probably just how much is on the agenda right now and how much there is to do.”

“ Change in our operating model depends on the change in the business model which depends on regulation.”

“Regulatory trends and uncertainty are choking growth in the West”
The world we live in – Risk management landscape

Extending CFO role

Focus on value drivers and performance
“Business partner,” supporting strategic decisions
Leads communication of performance to stakeholders

‘Strategic’ Finance
- Performance measurement
- Capital projection and optimisation

‘Operative’ Finance
- IFRS
- Compliance reporting
- Management reporting
- IT systems and data

Extending CRO role

Active management of risk profile
“Business Partner,” supporting strategic decisions
Leads communication of risk profile to stakeholders

‘Strategic’ Risk
- Risk appetite/tolerance
- Risk return trade-off
- Diversification impact of opportunities

‘Operative’ Risk
- Control of individual risks and portfolio concentrations

KPMG
The world we live in - Summary

The unknown

- Extreme energy price volatility
- Water security
- Climate change
- Asset price collapse
- Global imbalances and currency volatility
- Food security
- Fiscal crises
- Corruption
- Organized crime
- Fragile states
- Internet data and information security
- Critical information infrastructure breakdown
- Illicit trade

The known

Compliance

African Actuary in a Global Village

2011 CONVENTION 8 – 9 NOVEMBER
The role of the CRO – The task team

• Task team set up by EFRM committee on behalf of council to
  • Investigate role of CRO, and related roles
  • Representation from LAC, STIC, RM, EFRM, B&F, Health
  • Mandate focus on opportunity and professional matters

• Emerging conclusions (work in progress):
  • CERA provides an excellent theoretical platform
  • Theoretical knowledge only part of requirement
  • Enough reason for explicit guidance
  • Comprehensive guidance will take time
  • Other Actuarial bodies active in ERM research
  • Adoption of a standard similar to ASB’s draft ASOP on ERM may be good first step
What does this mean for actuaries?

“In exercise of the enterprise-wide role, the CRO would be expected to be in a position to assess, independently of the executive in individual business units, and with due regard to materiality, whether a proposed product launch or the pricing of risk in a particular transaction is consistent with the risk tolerance determined by the risk committee and board, and should be able to exercise a power of veto where necessary.”

Walker Review, 2009
What does this mean for actuaries?

International actuarial guidance for actuaries in risk management:

<table>
<thead>
<tr>
<th>Body</th>
<th>Document</th>
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<tbody>
<tr>
<td>IAA</td>
<td>• Role of the Actuary in ERM</td>
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<tr>
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<td>• Note on Enterprise Risk Management for Capital and Solvency purposes in the Insurance industry</td>
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<td>• Comprehensive actuarial risk evaluation (CARE)</td>
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<td>• Projects on Own Risk and Solvency Assessment (ORSA) and Actuarial Review of Risk Management Practices</td>
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<tr>
<td>USA &amp; Canada</td>
<td>• ASOP no. 12: Risk Classification (for all practice areas)</td>
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<td>• Draft ASOP on ERM</td>
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<td>• AAA Committee on Risk Classification: “Risk Classification Statement of Principles”</td>
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<td>• Enterprise Risk Management for Property-Casualty Insurance Companies</td>
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<tr>
<td>Australia</td>
<td>• Information Note: Actuarial Advice regarding Risk Management of a Life Insurer (LPS 220) or General Insurer (GPS 220)</td>
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<tr>
<td>UK</td>
<td>• ERM practice area established, but no formal guidance yet</td>
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What does this mean for actuaries?

ASOP on ERM

- Supplement to other standards
- Guidelines for “risk evaluation” and “risk treatment”
- One reason for guidance is to deal with regulatory compliance relating to professional opinions regarding risk management systems
- Applies to actuaries designing, using, or reviewing risk evaluation/treatment
- Evaluation: Focus on Economic capital, Emerging risks, other risk evaluations
- Economic capital: Highlights a number of considerations for the actuary
- Emerging risks: Predominantly considerations, leaving judgement to actuary
- Other evaluations: Predominantly considerations
What does this mean for actuaries?

ASOP on ERM

• Communications and disclosures: Advises actuary what “should” be disclosed, suggests the actuary discloses his/her credentials and expertise, statement of adherence to other specific actuarial standards, “appropriate assumptions”

• Risk treatment: Focus on Risk tolerance/appetite/limits, risk mitigation, emerging risks

• Predominantly considerations

• “Appropriate” assumptions highlighted as a responsibility

• Communications and Disclosures: Includes requirement to disclose departure from the standard
What does this mean for actuaries?

Does it matter that the CRO is an actuary?

- Professional work (opinion)
- Professional judgement (assumptions)
- Visibility
- Approval by regulators
- Bound by professional standards

- Is it different to other executive roles (CEO, COO)?
- Relevance of experience
- Fundamentally important to assess governance structure before position is accepted
What does this mean for actuaries?

Risk
- Require broad experience/skills
- Reputational risk
- No guidance
- Nobody to learn from

Opportunity
- Pioneering work
- A career path for CERA’s
- New industries
- Wider opportunity
Questions / Panel discussion

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References

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