Enterprise risk management: Global best practices and key challenges in Asia

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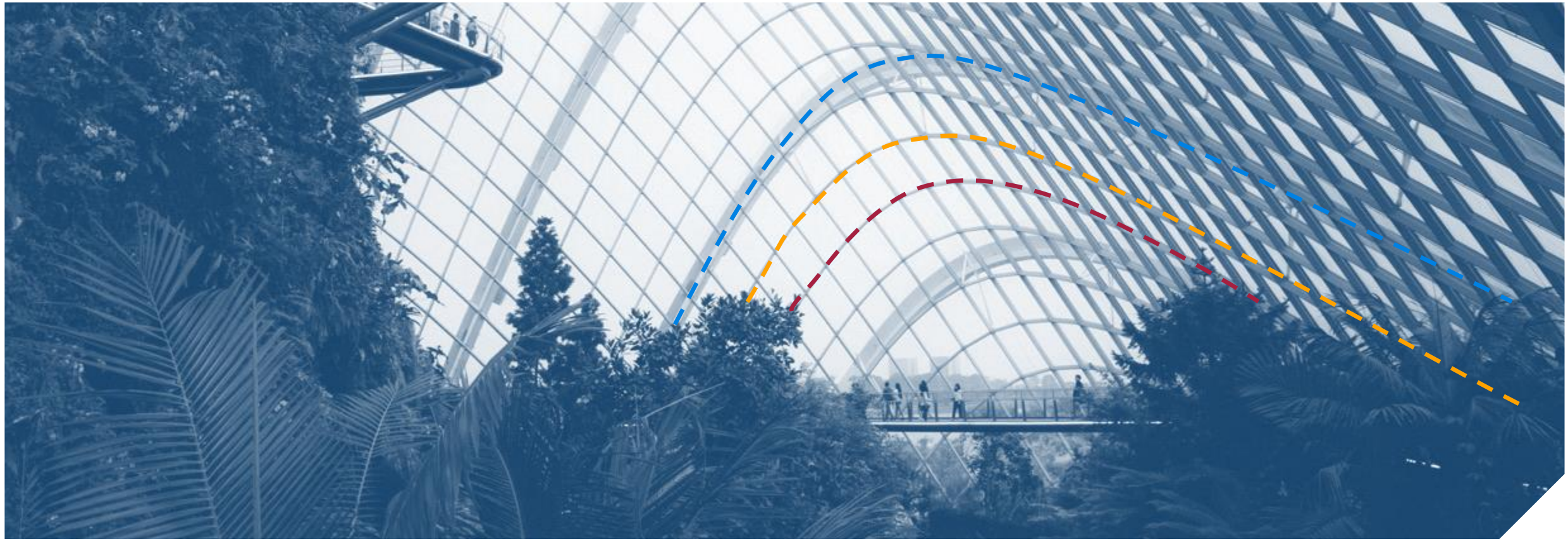
17 AUGUST 2018



Introduction

- In a fast-changing insurance environment, with tech innovations and disruptions, **how is risk management keeping up?**
- How does the risk function evolve from a traditional compliance function to a strategic business partner preparing the business for the evolving emerging risk environment?
- To help examine the **evolution of the risk management functions in Asia**, we recently carried out a **study**, complimented by a **pulse survey**, that assesses the position of Asian life insurers on the **journey toward global best practices** of risk management capabilities, from viewing risk management as a **control function**, to becoming a provider of value-added insights to the business, to ultimately assuming a **leadership role as a business partner advising on key decision-making**.
- In this session we will present key insights and focus on areas of developments in the Asian life insurance market from the research report, supplemented by survey results.
- We will also **highlight and discuss the role of risk in this fast changing environment**, noting the importance of risk measurement tools and risk culture in identifying and managing key emerging risks.

Disruptions are influencing the development of ERM

- Beyond an ever-changing landscape, the insurance industry faces increasingly complex business challenges and new risks. Insurers **must develop new Enterprise Risk Management (ERM) practices to manage a wide array of diverse, emerging risks alongside traditional risks**.
- There is increasing recognition globally of the value that can be created by strong risk management frameworks not only in responding to regulatory requirements, but also to **meet demands from boards for better risk oversight, manage increased industry volatility, identify emerging risks and to gain greater competitive advantage**.
- Risk management is being taken more seriously among insurers in Asia, but **too many boards across the Asia region still doubt the value of making upgrades to their processes**.

Our ERM study

- For the study, we interviewed **9 regional head offices**, with operations in the **12 largest insurance markets in South East Asia**. They have a combined market share of more than 50% in six of the 12 countries.
- To identify the stages of evolution of risk management within organisations, we have categorised companies by stages of evolution of risk management.
- Our participants are at various stages of ERM evolution, with **the majority falling into the 'Transitionals' category.**

Beginners

- Respond reactively to incidents and focus on limiting losses.
- Manage risk typically in silos.
- Are at the early stages of considering and implementing ERM as a process that creates value.

Transitionals

- Identify issues proactively
- Have formalised an ERM program that allows for a degree of risk return optimisation
- But require further development in terms of integration and collaboration.

Trendsetters

- Create value through ERM
- Considered risk management practice in the strategic planning process.
- CROs formalised ERM process and embed it more deeply.

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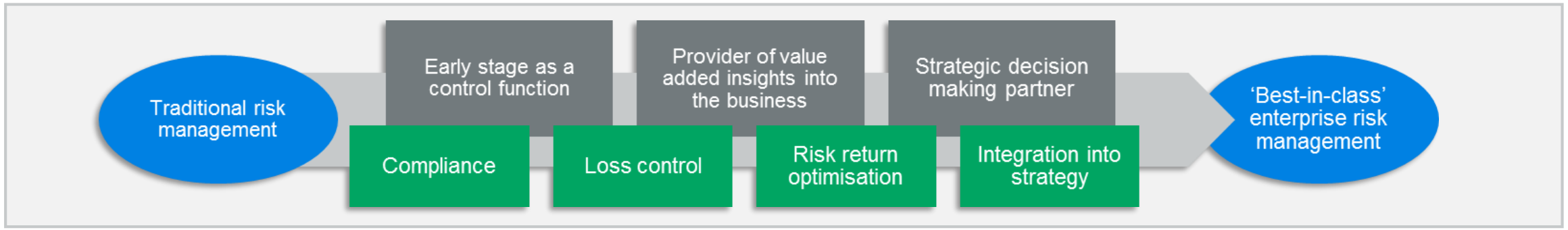
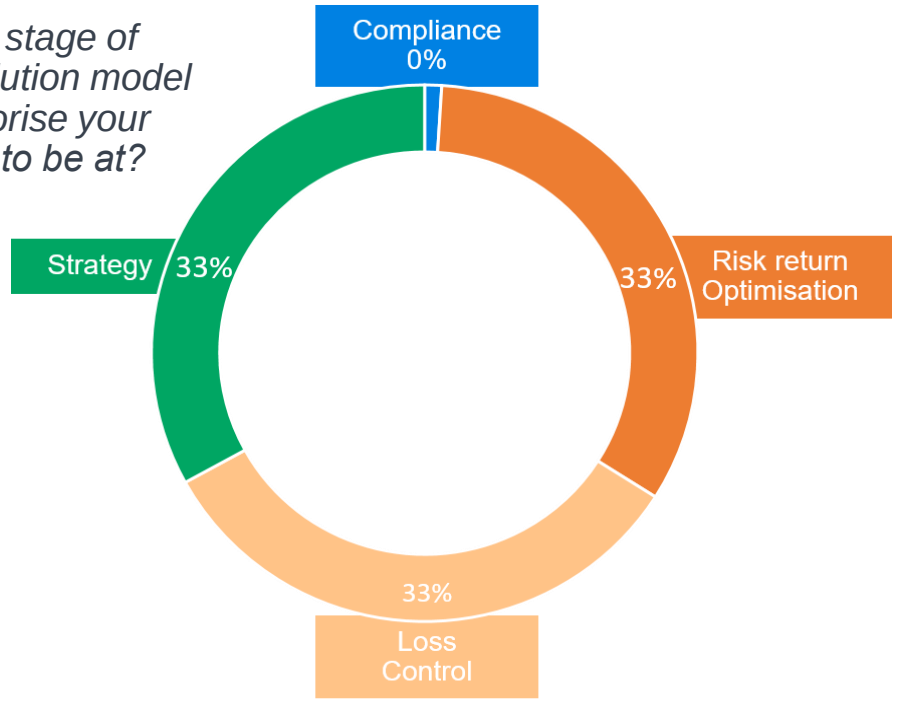
Evolution of ERM and participants' self-assessment



Survey question: *What stage of development, in the evolution model above, would you categorise your Company's risk function to be at?*



- None of the participants viewed themselves as having risk management purely for compliance purposes.
- A third of the study participants identified their respective risk functions as still being focussed on loss control.
  - At the regional/group level - can be different at the local business unit level.
- Regulations can support the advancement of ERM practices.
  - In particular, companies with parents that need to report under a global regulatory framework tend to have more sophisticated frameworks.
- We also observe that companies are increasingly placing more value on ERM, and see it is as a partner for making better decisions and to improve business processes.

How is ERM keeping up? (1/2)

‘Best practice’ classifications

Senior ownership and sponsorship for risk management

- Board has a primary responsibility for setting the ‘tone from the top’
- Sponsorship allows more **resources to be devoted to the development of the risk function amid ‘the fight for capital’** in this new environment.

Senior management remuneration incentives

- To encourage a business strategy that incorporates full risk/reward considerations, Key Performance Indicators (KPIs) for senior management need **to incorporate risk assessment when pursuing strategic initiatives**.

Risk authority and responsibility

- Well-designed governance structures add value by creating **efficient, aligned processes with clear responsibilities and roles** for project teams involved in tackling disruptions.

Identification and reporting of material risks

- Companies need to build a risk capability that works closely with the business to **provide new levels of insight so as to identify emerging risks, particularly those that come with innovations and new ventures**.

Staff expertise and skills

- Need to be staffed by appropriately trained individuals who have a **clear mandate in areas such as methodology development, reporting and specialist support,** including emerging risks, such as cyber risk

How is ERM keeping up? (2/2)

‘Best practice’ classifications

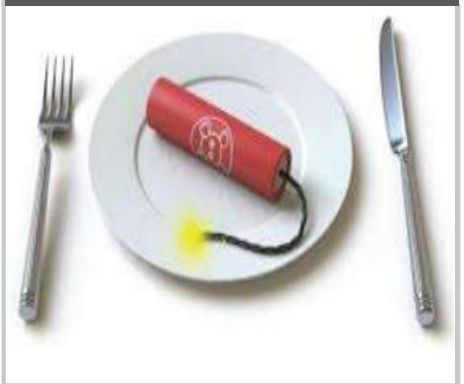
Risk capital planning

- Risks associated with **new business units, channels and products should be identified and used for capital budgeting purposes**.

Stress testing

- Stress scenarios used to test and improve the control mechanisms of the company.
- Management able to **focus on contingency actions available to them to help recover the business in stressed scenarios**.

Risk appetite and limits



- Risk appetite frameworks that **are connected to a firm’s vision, strategy and the way it functions** provide a more solid platform for better informed business decisions.

Risk assessment for new products and ventures

- Risk management viewed as **a business partner, not an inhibitor to initiatives**.
- Process of evaluating the risk characteristics of the new venture may be key to the ultimate implementation decision.

Risk culture

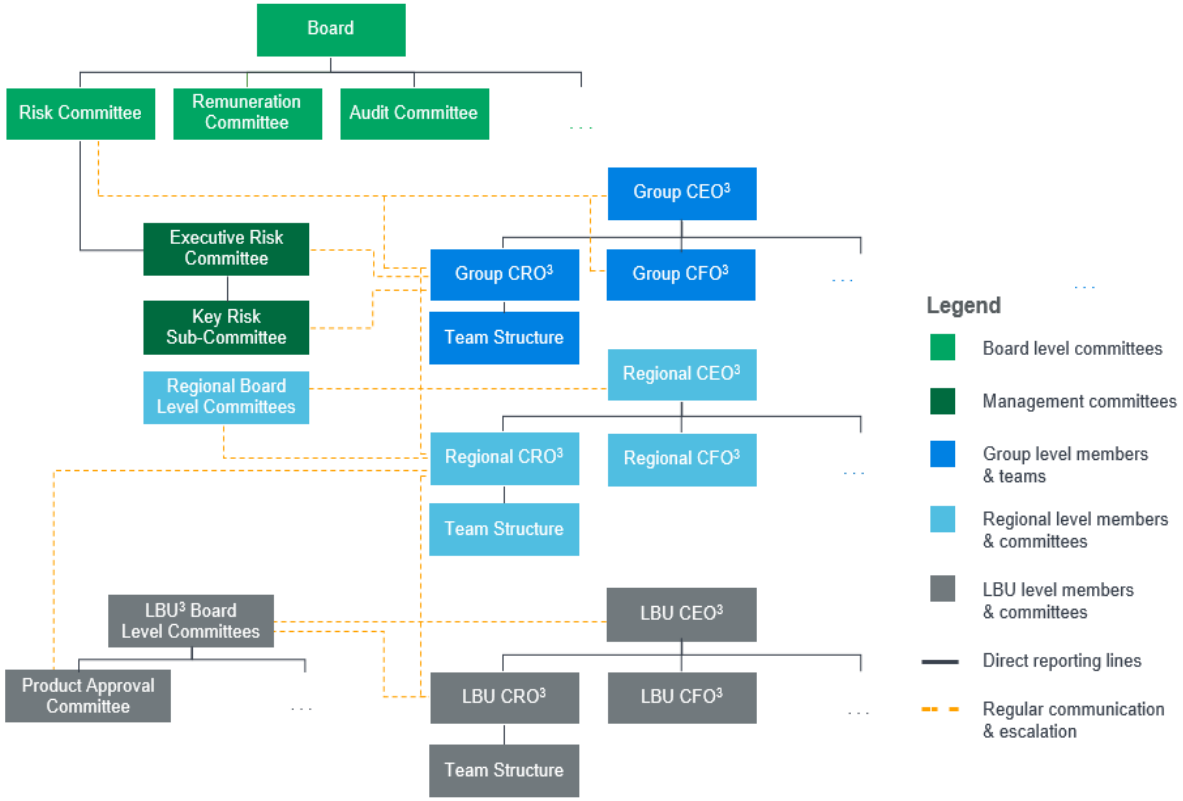
- A risk-aware culture **greatly expand the ability to identify, communicate and address risks more efficiently**, as well as opportunities arising from those risks.

Global best practices and key challenges in Asia

Areas of focus:

- Senior ownership, sponsorship and developing a risk culture
- Risk authority and responsibility
- Identification and reporting of material risks
- Staff expertise and skills
- Risk capital planning and Stress testing
- Risk appetite and limits

Senior ownership, sponsorship and developing a risk culture



Global Best Practices

- Strong reporting lines, similar reporting and committee structures at group, regional and Local Business Units ("LBUs").
- Regular communications between group, regional and LBUs.
- Risk function with sufficient resources.
- Clearly defined risk management roles and responsibilities.
- Independent board-level risk committee exists
- CRO with regular representation at board-level committees, the audit committee and key subcommittees.

Challenges observed in the Asia region

- Obtaining consistent board and senior management sponsorship.
- Demonstrating the value added by risk management.
- Regular risk function representation at board and on key executive committees.
- Even where sufficient sponsorship and budget existed, it is often difficult for risk functions in the Asia region to perform a more comprehensive, forward-looking role because of resource and skill shortages.
  - Resources allocated to 'fire-fighting'.

Developing a Risk Culture

- Clear and open communication channels established among group, regional and local business units, and across function lines.
- Embedding an enterprise-wide risk culture, with strong board and senior management sponsorship.

Risk authority and responsibility

First line of defense

Business unit

Second line of defense

Risk control function

Third line of defense

Audit assurance

Global Best Practices

- Responsibilities are documented to ensure that roles are clearly defined throughout the organisation.
- Identify individuals accountable for risk and other individuals secondary to the decision-making process.
- Clearly defined roles and relationships among organisation, especially compliance, risk management and internal audit.
- Separation of duties prevents conflicts of interest among associates rewarded for risk-taking and those responsible for identifying excess risks.

Challenges observed in the Asia region

- Ownership of risk assessment and management at each critical juncture.
- Creating an organisational structure that embeds and encourages a healthy risk culture.
- Implementing and embedding a clear 'three lines of defence' (3LOD) model.
- Companies in the Asia region have at least some documentation around 3LOD, with roles defined at a structural level for each line of defence. However, in practice, the implementation of the framework varies across companies, with some lacking the specificity to make it meaningful.
    - There is still dissonance on individual roles in the process.
    - Communication and process lines can also be further improved.

- The challenge is for companies to diagnose whether their organisations are truly embedding a 3LOD framework that assists risk considerations at each decision-making stage, and to define a risk culture across the organisation.
- Is the governance structure creating efficient, aligned processes with clear responsibilities and roles for teams tackling disruptions?

Identification and reporting of material risks

Survey question: *How much time does the Risk function devote to managing the business relative to fulfilling the regulatory /compliance agenda?*

- Workshops and forums on emerging risks could help key staff identify potential risk events. Enhanced stress and scenario testing could be used to improve capabilities to provide new levels of insights, including assessing and quantifying emerging risks.
- Cyber risk is receiving greater management focus in Asia, however, greater development is still required.
- Awareness of fast-evolving areas like insurtech, the use of artificial intelligence (AI) and chatbots and a need to understand their risks and implications.

Global Best Practices

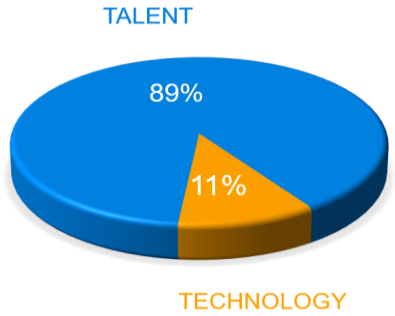
- Established risk appetite statements and limits, with a monitoring process that actively manages and reports risk exposures.
- Risk reporting tools such as a risk checklist, risk register, risk heat map and risk dashboards adopted ensuring timeliness and quality of risk reporting to senior management, along with periodic risk reports such as the ORSA.
- Involvement of all key risk owners in the identification of risk and aggregation of all risk exposures, allowing for diversification of risks.
- Reassessing the relevance and effectiveness of risk management systems and reports on a regular schedule.

Challenges observed in the Asia region

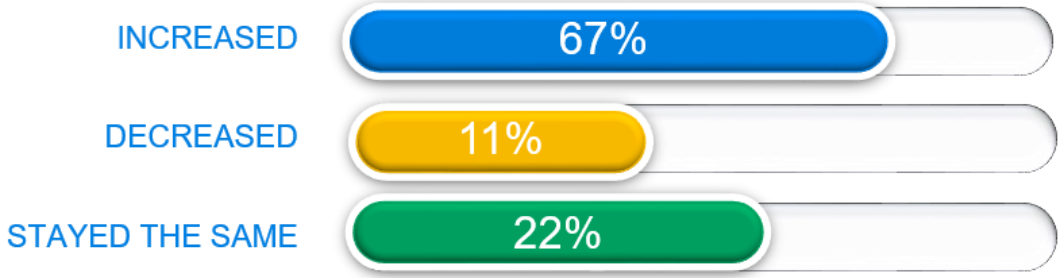
- Developing consistent reporting tools such as a risk checklist, risk register, risk heat maps and risk dashboards.
- Despite some risk tools and structures being in place, there is a high level of dependency on staff skills and availability for risk identification.
- Technical and actuarial staff skills training and development.
- Greater focus is required in assessing and managing qualitative risks such as reputational and regulatory risks, operational and emerging risks, including cyber risk.

Staff expertise and skills

Survey question: *Currently, where does your risk function require more investment: talent or technology?*



Survey question: *Year-on-year has the budget of your risk function increased, decreased or stayed the same?*



Global Best Practices

- Investment in talent seen as critical to develop the risk function.
- An embedded risk culture and sponsorship from senior leadership, with defined strategic priorities, key to identifying needs for the development, training and recruitment of skilled staff.
- Team with sufficient expertise to perform the risk management functions and offer adequate systems supports.

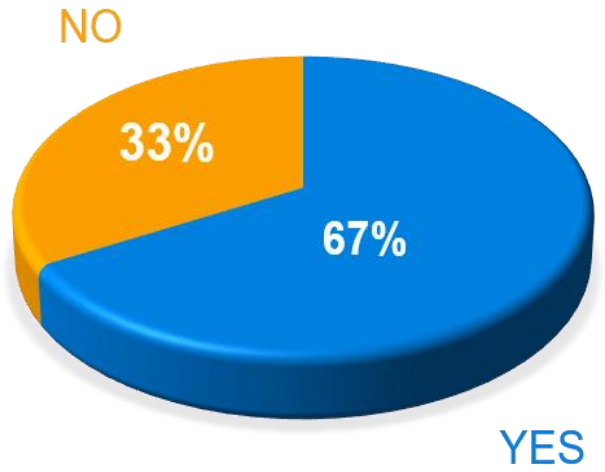
Challenges observed in the Asia region

- Formalised process of interaction among group, regional and local business units to identify and develop required skill sets.
- Development of a team with balanced abilities, including a range of technical and soft skills.
- Focussed investment in recruitment and training. A lack of sponsorship restricts the ability of the function to invest even where known skill gaps exist.

- A lack of technical and actuarial expertise increases the level of dependency of the risk function on other first-line defence functions. This reduces its ability to consolidate and investigate the root causes of risk issues and restricts the function to risk reporting rather than evolved forward-looking risk management.
- Need to be staffed by appropriately trained individuals who have a clear mandate in areas such as methodology development, reporting and specialist support, including emerging risks, such as cyber risk

Risk appetite, capital and stress testing

Survey question: *Do you currently calculate economic capital and/or have an internal model in place?*



- Risk appetite statements defining quantitative, qualitative and strategic risk exposures.
- Setting exposure limits for each material risk based on the insurer's risk capital and appetite.
- Stress and scenario testing can be used as a management simulation exercise to work on real-time responses that will be required of management in terms of actions to take and public statements to make under stressed conditions.

Global Best Practices

- Board ownership of risk appetite with regular reporting.
- Identifying risks associated with LBUs and products for capital budgeting purposes and development of capital allocation process.
  - Capital budgeting is the process of choosing and approving plans for capital usage that maximise the fulfilment of corporate goals for the amount of capital used.
- Use of stress testing to understand the full nature and shape of the risks of the company, and to test and improve the control mechanisms of the company.
- Development of management and recovery actions plans dealing with stressed situations through conducting stress and scenario testing.

Challenges observed in the Asia region

- Developing risk appetite frameworks in line with a firm's vision and strategy, assisting better informed business decisions.
- Developing and consistent implementation of risk-based economic capital metrics across the group.
- Use of economic capital metrics in forming management's view of capital budgeting and risk-adjusted returns.
- Use of stress testing, beyond basic regulatory requirements, for use in business and strategic planning; and formulating management responses in recovery scenarios.
- Use of stress testing to quantify emerging and remote risks.

Conclusion

- Developing a risk management framework is an ongoing process that consists of strategic setting of objectives, along with risk-identification, risk-assessment, risk-monitoring and risk-incidence procedures.
- A well-defined framework addresses the interactions of the executive risk management committee with the staff who are identifying risks, the criteria for measuring the likelihood and severity of risks and the design of questionnaires, workshops and other methods of identifying risks.
- With such a programme in place, an insurer can enhance internal and external customer service, protect its financial and human capital resources and safeguard the organisation's reputation.
- Some of the key challenges in the development of risk functions observed in Asia are:
    - Building a business case to obtain senior ownership and buy-in
    - Establishing risk management frameworks with clear ownership and responsibility
    - Creating quantitative risk assessments and reporting for all key risk exposures
    - Attracting and retaining the right staff talent and skills
    - Developing capability to identify and quantify emerging risks in a timely manner
- Focussed investment to develop best practice will help build a risk management framework that creates measurable value, while making enterprise-wide risk management much more effective at responding to a rapidly changing risk environment.

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Any questions?

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