

ERM 2010 Seminar Report:

An edited version of the following article appeared in the October edition of Actuary Australia.

The second, highly successful Enterprise Risk Management Seminar was hosted by the Institute in Sydney on Tuesday 21 September 2010.

The theme **ERM 2010 – It's All About Opportunity** looked at ERM as a way for Corporates to optimise risk taking while highlighting the opportunities for professionals to adapt their skills to this emerging area of practice.

Over 120 high ranging risk professionals attended the seminar and contributed to the days proceedings. Participation reached out beyond our membership with 34% of attendees working outside the profession. High level speakers and a power packed **ERM Survey**, released at the event, helped generate significant coverage in the press.

The day was segmented into four sessions broadly covering the following areas:

- Business Risk and ERM and its implementation
- Scenario testing Risk Appetite
- The role of the CRO in Risk Appetite, and
- ERM in times of Crisis.

The following provides a flavour for the content of the day.

Business Risk & Enterprise Risk Management

Craig Dunn, CEO of AMP, shared AMP's ERM journey to date, with some insights on how effective risk management provides opportunities to create greater value.

Craig pointed out the importance for risk appetite of 'making it real' – if ERM does not improve decision making by business leaders, then it is not an effective system. This is one of the reasons that AMP has focused on "profit at risk" as a key measure as easier for line management to understand than risk based capital measures.

At AMP, setting risk appetite is through an iterative and dynamic process – agreeing risk appetite with the Board, translating this into risk budgets for different parts of the organisation and then cycling back to the Board to discuss implications.

AMP's ERM approach has led to some key business decisions, eg closing the annuities book to 'free up' risk for areas with potential to generate greater returns.

Craig stated that having the right culture is vital – this was a theme reinforced by a number of speakers. AMP's risk management culture involves:

- empowering business leaders to make decisions, and including ensuring they understand their risk budget and trade-offs they need to make
- ensuring that there is a common risk language across the organisation
- regularly checking that risk models are consistent with real life experience

Craig laid down the challenge to the members of the audience to think how they can use their technical and professional skills to partner with business managers to manage risk effectively and maximise potential upside for their organisations.

Tips and Traps for Implementing Risk Appetite

Mark Lawrence highlighted the increased focus now on risk appetite as the GFC showed that many companies were taking risks that were not understood or were not authorised by the Board. The Senior Supervisors Group 2009 report on "Risk Management Lessons from the Global Banking Crisis" stated that the second of 10 critical areas for

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improvement was articulating a robust risk appetite statement and board involvement in setting and monitoring adherence to the firm's risk appetite.

Mark illustrated the challenge of implementing risk appetite by outlining eight high level implementation steps, along with the range of impediments that can arise at each step. Mark's tips included the need to recognise that each firm will address ERM differently, but an organisation should start with a simple approach with a focus on major risks first, and then take an iterative approach from there.

Damien Green, CEO of AIA, outlined four steps to create a foundation for implementing ERM:

1. Ensure the ERM framework is proportionate to the organisation's stage of maturity,
2. Ensure culture and behaviours align with, and support, the ERM framework,
3. Give permission for ERM to represent upside and downside risk.
Business leaders need to be empowered to make decisions for upside and downside risk taking, and
4. Link emerging risks to business strategy

Hypothetical – Road Test Your Risk Appetite Through Scenario Testing

The 'Hypothetical' session explored the concept of scenario testing as a way of preparing organisations to respond to crisis events. Anthony Bice chaired a panel of experts as they discussed three potential disaster scenarios. The panel consisted of experts from different fields – Andrew Hinchliff from the world of investment banking; Rob Daly representing life insurance and Tony Coleman providing a general insurance perspective. Scenario 1 was that a Global Double Dip Recession occurred that impacted Australia; Scenario 2 envisaged a massive terrorist attack on the Sydney CBD; while Scenario 3 contemplated the extreme weather events that are expected to be caused by climate change.

The discussion showed the strength of scenario testing as a way of identifying critical issues, many of which were not obvious at first glance. A number of examples surfaced. Who realised that the exchange rate impacts of a recession may affect the price of car parts, which could in turn push up motor insurance claim costs? Or that, the 9/11 experience shows that there may be a wave of disability claims from those involved in cleaning up toxic material after a terrorist attack? Many people may think of rising sea levels as a substantial issue for insurance companies, but who realises that banks may face greater risks due to their mortgage portfolios?

The session was a great advertisement for scenario testing as a technique and it may prove a spur to many to try it in their own businesses.

CRO's Role in Risk Appetite

The third panel session, on the CRO's role in Risk Appetite, was facilitated by Fred Rowley and the three panellists were Mike Thornton (CRO of Axa Asia-Pacific), Mark Baxter (CRO of Commonwealth Bank's Wealth Management division) and Robert Stribling (CRO of Suncorp-Metway).

Mike led off on the role of the CRO, which he said was to ensure that RM focuses on low probability, high impact events, to build an effective RM capability and to embed Risk Management into the organisation's corporate culture. In terms of the analysis made famous by Donald Rumsfeld, a good CRO should manage the known unknowns (avoid the worst risks - e.g. sub-prime loans) but also try to identify the unknown unknowns - the emerging risks that are not yet on anyone's radar. Finally, the CRO has to articulate the risks to the Board and the CEO.

The CRO has to imagine a variety of unforeseen scenarios - "think the unthinkable", and ask whether the Board can live with the consequences.

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Mike said that it helped to develop simple scenarios, to test the impact on key financials and reputation, and to mitigate risks. He said it was important to keep communication simple, and that ultimately sound governance is the key.

Mike said that there is scope for a larger role to be played by actuaries - the challenge for actuaries is not a technical one, it is to communicate well, in order to be effective in interactions with senior management and the Board.

The second presenter was Mark Baxter, and his presentation focussed particularly on the development of a Risk Appetite Statement (in which the Board had been fully engaged). Since the development of the high level Bank Risk Appetite Statement, Business Units had since implemented and took ownership of their own Risk Appetite Statements. In CBA the role of the CRO was only to facilitate the discussions, and used some useful tools such as "voting tool" technology to ensure individual's views were unbiased.

Mark emphasised the need for Risk Appetite:

- to be articulated in very clear language understood by the business (eg. "we want our mortgage default rate to be less than y"),
- set clear boundaries on risk for the organisation,
- encompass both qualitative and quantitative metrics,
- be both dynamic and iterative, and
- be cascaded down to and owned by the Business Units.

The Risk Appetite Statement should concentrate on Profit Volatility and Capital Resilience and needs to be integrated with governance, policies, leadership messaging, the HR agenda (hire risk-aware people, instil risk awareness training) and management reporting (risk KPIs dashboard).

Robert Stribling was the final presenter and a key theme was that risk management needs to take into account that in an actual risk emergency, people's actions would be dictated largely by their animal instincts (fight or flight). But we should aim for a structured, measured process citing the example of the military who train their people to think quickly and clearly under pressure (Suncorp's CEO used to be a tank commander.)

BP's internal investigation of the recent oil explosion disaster had revealed that culture played a critical role in the disaster. The manuals and guidelines were fine - it was just that in practice they weren't followed, because people under stress were not complying. The suggestion was that there was a culture where there were consequences for staff who failed to meet internal targets - therefore they "cut corners" to "get the job done". At several key points, lower level staff fell back on gut instinct. A better culture could have avoided the disaster, but employees are often afraid of speaking up - a recent survey suggested that 59% would be reluctant to bring bad news.

Robert said that risk management is still a young profession, and that the GFC showed that we are still missing the significance of culture as a key issue. Models, properly implemented and developed, in the hands of professionals, have a role to play.

Robert said that there is a lack of clarity about what "risk appetite" means, and he tried to counter some common misconceptions:

- There is not one Risk Appetite; there are multiple risk appetites, which vary according to activity across an organisation.
- Risk appetite is not a constant.
- Risk appetite cannot be considered in isolation but should be considered in conjunction with stress testing, capital plans, strategic plans (business growth etc).
- Risk appetite cannot be viewed in isolation but is inextricably intertwined with risk culture.

ERM in Times of Crisis – What Happens When it All Hits the Fan?

The last session was predominately focussed on the Cultural aspects of ERM and in particular the role of Leadership. This was tackled by hearing the "War Stories" from Warwick Young and Peter Clarke with Colleen Guray drawing from those experiences to highlight the behavioural aspects of a crisis.

As CFO of an AIG subsidiary in Japan, Warwick Young had to deal with the unexpected during the GFC. In the last session of the seminar, Warwick spoke graphically about his company's sudden change in circumstances, the implications of the prevailing culture, the unexpected events and some of his learnings.

What were some of the issues facing Warwick in his effort to avoid being the CFO of a failed Financial Institution?

- The threat of sustained policyholder redemptions and collapsed asset values
- The breaking of contractual obligations of third party providers who were integral to the pre-determined risk mitigation strategies of ALICO,
- The reluctance or inability of the local executive to consider the broader corporate implications of their actions,
- The physical and mental toll of the prolonged crisis, and
- The tendency of individuals to position themselves politically for life beyond the GFC to the detriment of the current environment.

Some of the ways in which Warwick would position the company differently in preparation for a crisis?

- Identify a crisis team in advance
- Prepare for parent failure,
- Remove single point sensitivities in respect to service providers,
- Run a realistic mock crisis in an offsite, and
- Ensure the needs of staff are fully catered for in the crisis (i.e. transport, rest and communication to spouses)

In a different environment, Peter Clarke recounted the leadership challenge when his submarine lost power during the Cold War and descended toward the sea bed. Although nuclear submarines are highly regulated, the unusual circumstances meant that normal processes didn't work and 20 pairs of eyes all more technically proficient in their areas of speciality, looked to him for guidance.

As an organisational psychologist, Colleen Guray discussed people's changed behaviours during a crisis, suggesting that organisations need to recognise these different reactions. The CEO has a particular responsibility to make sure that the organisation's risk culture is robust and effective.

The speakers indicated that organisations should recognise that rules may be inadequate in a crisis and that people will require leadership decisions based on personal values and gut feel. Organisations should ensure that their leaders are well trained and suitably experienced.

Feedback and Ongoing Involvement

The feedback indicates the seminar was a great success with the focus on the practicalities of ERM in a business, leadership and culture very welcome. The organising committee is very thankful to the speakers for the quality of their insight and also to the sponsors for their support.

The Institute would like to thank the seminar sponsors Goldman Sachs and Milliman for their support. We would also like to thank our Supporting Partner the Risk Management Institute of Australasia for promoting this event to their members.

The Institute would like to make special mention to Wayne Brazel of AMP Chair of the Risk Management Practice Committee's Events organising committee, Eric Cheng and members of the committee who put in a huge amount of time and effort to make this seminar such a success.

While we believe it to have been a great Seminar, it is only the start! We encourage members to be involved with the **ERM Community** through its periodic Community Sessions, **LinkedIn forum** (<http://www.linkedin.com> Group: "ERM Community of IAAust") and the periodic newsletter. We look forward to welcoming risk management professionals to the seminar next year.



The podcasts of the sessions are available on the Institute's website together with a more detailed version of this article.

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