

# GI in a GFC World

General Insurance Impacts of the Global Financial Crisis



Institute of Actuaries of Australia

Wednesday, 24 June 2009

THE WESTIN SYDNEY 1 MARTIN PLACE, SYDNEY

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## Lessons for Risk Management Framework

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## GFC Lessons

- Systemic risks
  - Asset return 'distributions' potentially require additional variability or shock scenarios
  - Dependencies with other relevant economic factors, such as unemployment, house prices, corporate insolvencies need to be revisited
  - Over reliance on rating agency rankings, not allowing for transitional probabilities to lower ratings and insolvency
- Risk models
  - Inadequate dependency and variability outcomes of contractual outcomes to economic conditions
  - Need for external shock scenarios as well as internal operational shocks
  - Incentives to understate Value at Risk (VaR), inadequate frameworks for objective assessment of VaR
  - Insufficient focus on tail of outcomes beyond the VaR



## GFC Lessons

- Enterprise risk management
  - Model of setting VaR per BD or Product leads to understatement of risk accumulation.
  - Limited information around accumulation of beyond VaR risks
  - Capital allocation methods encourage a 'non contagion' culture
- Reporting and information flows
  - Enhanced reporting regime on risks to Corporate
  - Enhanced reporting of risks and accumulation to Executive and Board
  - Greater consistency in reporting upon risk in financial statements, disclosure of VaR or other risk metrics



## GFC Lessons

- Risk culture
  - Independent review of contracts and products, pricing and provisioning by appropriate professionals
  - General improved culture that balances consideration of upside and downside risks
  - Stronger control cycle principles to ensure an encompassing product development, risk assessment, pricing, monitoring, revaluing and feedback to next iteration of products
  - Greater power and accountability afforded to a separately mandated risk team



## GFC Lessons

- Research
  - Inadequate research into technical, behavioural and other aspects influencing economic outcomes
  - Utilisation of outdated models, some developed in 1960s, with limited explanatory power
- Regulation
  - Counter cyclical capital requirements
  - Sophistication of minimum capital requirements to match contracts and products on offer
  - Provisioning standards with respect to contracts/ products
  - Greater geographic cohesion