Webinar Instructions

• Help for IT Problems
• How to Submit Questions
Welcome and Introductions

Welcome

Moderators
  – Pedro Pacheco Villagrán
  – Marc Slutzky

Presenters
  – Ralph Blanchard
  – Nick Dexter
  – Sam Gutterman
  – Godfrey Perrott
What is the Risk Book?

- A dynamic resource for Risk Professionals who deal with Insurance
- Help to measure, manage, and mitigate risk
- Developed and maintained by the Insurance Regulation Committee
  - (10-20 pages per chapter)
- Provides insight and context to many major risk topics in easily digestible bites
This Webinar

• Will give you insight into the Risk Book
• Focuses on a few chapters
• Why we wrote these chapters
• Why they are meaningful
Chapters to be Discussed

- Chapter 8 - Insurance Groups (Ralph)
- Chapter 7 - Intragroup Reinsurance (Ralph)
- Chapter 9 - Distribution Risks (Sam)
- Chapter 11 - Resolution of Insolvencies (Nick)
- Chapter 15 - Governance of Models (Godfrey)
Chapter 8 - Insurance Groups

Reason for the Chapter?
• Much is written about insurance “company” risks, but groups add another dimension to those risks

Goals
• Point out what makes risk management different for groups
• Identify key considerations from both legal entity and group perspective
Groups – Key points

Every Group is different

- While different groups can share certain features, they aren’t all the same.
- Some centralized, some decentralized. Both approaches can work.
- One size does not fit all.
Groups – Key points - 2

Scope of group (for risk management purposes) is defined by influence, not by affiliation

- If affiliate doesn’t influence the rest of the group (and vice versa), then no different from a non-affiliate investment from group ERM perspective.
- Don’t just look at common ownership.
- Look for cross influence.
- Within a group typically a group head or lead exists with potential to influence the rest of the group.
Groups – Key points - 3

Groups defined by their linkages

- Ownership
- Governance
- Capital
- Contractual
- Shared Resources
- Reputation
- Culture

Chapter 8 – Insurance Groups
Groups – Key points - 4

- In a group, group issues don’t replace legal entity issues, they co-exist
- Both sets of requirements must be met
- Understand the linkages
  - This is important both for legal entity ERM and group ERM.
Groups – Key points - 5

• Both group capital and legal entity capital are relevant
• Groups typically have greater access to capital markets, but ...
• Location of the capital matters
• Fungibility matters
Groups – Key points - 6

- Groups can have multiple supervisors/regulators
- They can have different objectives, different approaches
  - E.g., Bottom up vs. Top down
- For group supervision to work, they have to cooperate.
Groups – Key points - 7

- Some form of Group ERM is needed
- Doesn’t have to be centralized, but needs to be coordinated across the group
Chapter 7 – Intragroup Reinsurance

Reason for the Chapter?

• Much was already written about Reinsurance, but not about Intragroup Reinsurance (IGR)
• Understanding the role it plays is important for understanding how a group may operate.

Goals

• Identify how IGR may be different from other reinsurance
While should be priced as if “arms length”, it is not “arms length”

- Need to look at motivations, structure
- Conflicts can arise
- May be more for group reasons (e.g., capital management) than legal entity needs, but
- Should be beneficial to all parties.
IGR – Key points - 2

Three parties to any IGR transaction

- Ceding Company
- Assuming Company
- Group Head

As they are all “related”, actual transaction should process smoothly.
• Same types as regular reinsurance (quota share, excess, cat, stop loss)
• Frequently a form of capital management
• Move the risk to where the capital is for the group
IGR – Key points - 4

• Sometimes a risk is too big for a legal entity in the group, but well within total group tolerance
• IGR allows for this conflict to be resolved economically – risk spreading within the group.
Chapter 9 Distribution Risks

Reason for the Chapter?

• Actuaries need to increase their awareness of the distribution of the products they design and price
• Distribution risks often treated as a siloed risk, rather than a key risk of the insurer
• A key brand risk to the insurer as a going concern

Goals

• Raise awareness and encourage incorporation of distribution-related risks into ERM process
Chapter 9 Distribution Risks

- Risks to the insurer
- Risks to the distribution channel
- Risks to the consumer
- Roles of supervisors and actuaries
- Summary
Risks to the insurer

• Distribution risks are similar to operational risks – may be unpredictable, but can inflict significant reputational and financial costs
  – Selection can affect quality of distribution staff and in turn business volume and performance
  – Compensation can result in inappropriate incentives
    • As in recent Wells Fargo scandal, e.g., profit and brand damage and CEO termination
• Perceived concerns regarding sustainability or brand impairment can have serious short and long-term concerns
Risks to the distribution channel

• Any risk to the insurer or insurance industry is a risk to the distributor
  – Perceived concerns regarding sustainability or brand impairment can result in a rapid deterioration in the size and effectiveness of the distributor
• Insufficient support
• Continuity of distributor management
Risks to the consumer

- Inadequate education provided to
  - Distribution staff
  - Consumers
- Mis-selling
- Conflicts of interest
Role of supervisors

Charged with ensuring as far as possible

- Sales and service of insurance policies deliver acceptable value to the consumer, e.g., standards for agents, policy forms, prices and illustrations, as applicable
- Promises made are
  - Consistent with the public interest
  - Kept, e.g., sound insurers, receive complaints
Role of actuaries

• Involved in assessing the quality of sales and estimating policy performance in pricing process
• Help to identify, measure and manage the risks of the distribution and conduct of business
  – Part of overall ERM
• May need to sign off on the accuracy of illustrations of new sales / inforce insurance policies that explain the mechanics of complex or long-term products and information (advice) on the suitability of sales to customers
Summary

• Financial sustainability of an insurer is not often threatened by risks associated with its distribution system and marketing practices.

• These risks can lead to significant financial and reputational harm from lack of new business or poor quality of business.
  – In turn can adversely affect its income, brand value, and value as a going concern.
Chapter 11 Resolution of Insolvencies

Reason for the Chapter
• Recovery and resolution plans (RRPs) are a new but increasingly important concept for insurers for which best practice is continuing to develop.

Goals
• To explain the key features and scope of RRPs
• To provide a high level overview of the key steps in developing RRPs and in particular the role of actuaries in the process
Chapter 11 Resolution of Insolvencies

Recovery vs Resolution:

- Recovery – actions trying to prevent failure
- Resolution – mitigates the impact of an actual failure

Why undertake Recovery / Resolution planning?

- Identifying risks which might threaten business
- Take action to mitigate those risks
- Operationalise key actions
- Implement triggers for actions
- Meet requirements of FSB (for GSIIIs) and IAIS /local requirements
Balancing objectives

The authorities need to balance a number of different objectives with RRPs:

- Ensure the continuity of critical functions
- Avoid significant adverse effects on financial stability, including by preventing contagion, and maintaining market discipline
- Protect public funds by minimising reliance on extraordinary public financial support
- Protect client funds and client assets
- Avoid unnecessary destruction of value and to seek to minimise the cost of resolution
- Protect depositors as specified in insurance legislation and investors
The risk continuum

<table>
<thead>
<tr>
<th>Overview and Governance</th>
<th>Ops Structure and Current Exposures</th>
<th>Risk Assessment</th>
<th>Stress Testing</th>
<th>Recovery Plan</th>
<th>Resolution Plan</th>
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<tr>
<td><strong>As-is State</strong></td>
<td><strong>Significant ops and activities.</strong></td>
<td><strong>Significant risk exposures.</strong></td>
<td><strong>Stress and reverse stress (‘break the bank/insurer’) scenarios.</strong></td>
<td><strong>Contingent capital and liquidity.</strong></td>
<td><strong>Regulator takes control as receiver</strong></td>
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<td>overview</td>
<td>structure.</td>
<td>Systematically important operations and technologies</td>
<td>Events triggering resolution plan execution.</td>
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<td>Risk appetite</td>
<td>Key activity inter-dependencies.</td>
<td>Liabilities mapped to entities</td>
<td>Coordination with parent and liquidity priority.</td>
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<td>thresholds and metrics.</td>
<td>Material asset mapping.</td>
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<td>Risk management</td>
<td>Credit and Counterparty exposures.</td>
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<td>oversight</td>
<td>MIS and critical vendor relations.</td>
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<td>and approval as required.</td>
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<td>Supervisory authorities.</td>
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<td><strong>Current view of ability to release capital and liquidity</strong></td>
<td><strong>Develop and document contingent management actions and review ability to release capital and liquidity in response to stress</strong></td>
<td><strong>Ability to ‘unplug’ legal entities or economic critical functions and wind-down the firm</strong></td>
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**Preservation of franchise value**

- Business and strategic overview.
- Risk appetite, thresholds and metrics.
- Risk management oversight.
- Periodic (i.e., annual) with additional refresh, review and approval as required.
- Supervisory authorities.

**franchise risk/profit deterioration**

- Significant ops and activities.
- Legal and functional structure.
- Key activity inter-dependencies.
- Material asset mapping.
- Credit and Counterparty exposures.
- MIS and critical vendor relations.

**franchise destruction**

- Significant risk exposures.
- ‘Material’ business units, and legal entities.
- Systematically important operations and technologies
- Liabilities mapped to entities
- Concentration of business review.

Chapter 11 – Resolution of Insolvencies
Common recovery measures and potential barriers to resolvability

- Use of intra group loans/finance structures
- Internal reinsurance
- Support from external suppliers
- Disposal of valuable assets and business
- Support from regulators
- Strengthen capital position
- Legal entity structure
- Key Senior Staff
- Funding recovery

Chapter 11 – Resolution of Insolvencies
## Building on what we do now

### As-Is State

**Overview and Governance**
- Business plan and overview
- Risk Appetite Statement
- Risk vision and policy excerpts

**Ops Structure and Current Exposures**
- ALM reporting – credit concentration
- Legal entity documentation

**Risk Assessment**
- ORSA analysis
- ORSA/Internal Model reports and documentation
- Emerging risk assessment

**Stress Testing**
- Scenario analysis
- Other stress testing, inc RST

**Recovery Plan**
- Liquidity contingency plans / facilities
- Capital management

**Resolution Plan**
- Business Continuity Planning
- Intra-Group Agreements / outsourcing

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### Chapter 11 – Resolution of Insolvencies
Key messages

The most important points from this are:

- Recovery and resolution planning helps companies to understand how their business might fail and so make it less likely to fail.
- Supervisors get the comfort that were a company to fail it can do so in an orderly manner.
- Actuarial input is crucial given the need to understand the risks inherent in the business model.
- It builds on many of the tasks we currently undertake or are involved in.
Chapter 15 – Governance of Models

Reason for the Chapter?
• Various forces have converged to increase concern about models used in financial reporting and capital determination, and how they are governed.

Goals
• Show that model governance is critical and must be embedded in the organization
• Show that model governance is an ongoing process, not an end point
Sources of Concern

Major financial failures

• Long Term Capital Management (1998)
• Dysfunction in the 2008 Crash

Other forces

• Sarbanes Oxley legislation (U.S. 2002)
• Solvency II internal model requirements
• General concerns of the Financial Stability Board (FSB)
Long Term Capital Management

- Hedge Fund with a set of Blue Ribbon principals
  - Nobel Laureates
  - Prominent Wall Street Traders
- Bailed out by 16 banks in 1998 when it faced imminent collapse
- Claimed it was a 1 in 1 billion event that took it down
Sarbanes Oxley

- Legislation following Enron Crash
- Focused on documentation and transparency
- Only affected model governance tangentially
- However paved the way for future developments
Regulatory Actions

- Financial institutions (banks and insurers) were increasing use of models in management
- Pressure to use internal models rather than prescribed formulas to determine required capital
- Both the EU (Solvency II) and the FSB expressed concerns over internal models
- Formal governance of models is the result of these forces
Sources of Model Failure

- Failure of communication
- Cutting corners
- Hubris
- [Fraud]
Key messages

The most important points from this chapter are:

• Model governance and the management of model risk are critical considerations within the insurance industry.

• A formal governance structure is necessary to mitigate both operational risk and reputation risk.

• Risks include financial misstatements, or inappropriate reliance on model results for both strategic and operational decisions.

• Model governance is both complex and broad.

• Scope includes such as asset allocation models.
Thank you

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