Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Enterprise Risk Management in Insurance undertakings

Patrick Brady
Director, Policy & Risk
Fiona Muldoon
Director, Credit Institutions & Insurance Supervision

11 October 2012

The CBI Risk-based Supervisory Approach:

Assertive Risk-Based Supervision Underpinned by Credible Enforcement Deterrent

Assertive

- More challenging of firms – on business models as well as controls
- Opportunity for (time limited) dialogue – Central Bank needs to be satisfied concerns are taken seriously

Risk-Based Supervision

- Emphasis on conclusive mitigation of identified risks
- PRISM (Probability Risk and Impact SysteM) Framework

Credible Enforcement Deterrent

- Enhanced enforcement capability
- Identified enforcement priorities (eg, systems and controls, overcharging, low impact firms)

PRISM OBJECTIVES

- **International best practice** to operate a supervisory risk assessment framework (OSFI Canada, APRA Australia, DNB, UK FSA, US Federal Reserve, etc)
- A tool to **respond to supervisory lessons of the crisis** highlighted by Honohan, Regling & Watson, Nyberg
- A **consistent way of thinking about risk** across all supervised firms = a common cross-Central Bank approach; an ability to better manage our portfolio of 14,000+ firms
- A tool for the **allocation of resources based on risk** and helps explain the use of resources to stakeholders = more rigor in the application of resources and thinking about what activities to conduct
- A process that ensures a **minimum level of supervisory engagement for different classes of firms** = a clear and carefully considered strategy for minimum supervisory engagement that has been endorsed at Commission-level; no 'gaps' in supervisory coverage or engagement by covering all firms and all staff; a baseline to measure ourselves and to be judged by stakeholders; comfort to front line supervisors as to what is required of them
- A tool requiring **a systematic and structured way of assessing risks** in firms = ensure a comprehensive assessment of risk, with no gaps in assessments; more consistency in assessing similar risks, drawing on shared experiences (Explicit consideration of granularity/complexity vs usability trade-off in specification of scope and depth of risk scoring)
- Embedded guidance material to **prompt supervisory challenge and judgements**, not tick box approach
- A tool that requires **actions to mitigate risks** and tracks progress against these = keeps supervisors focused on outcomes (not just analysis of risk) and lets us see if issues are drifting
- Provides **clarity to firms** around our views of their risk profile and our expectations of them
- Built in **quality control mechanisms** to encourage challenge and sharpen the supervisory approach
- Allows **better management information** about the risk profile of the firms we are supervising

PRISM will help us enhance our focus on outcomes

- Check outcomes
- Re-assess firm

Impact Category → **Engagement Level** → **Assess Risk Probability** → **Internal Challenge** → **Risk Mitigation Plan**

Impact Category
- Categorize c 10,850 firms
- High/medium high/ medium low/low
- Prudential and Consumer impact
- Supervisory Engagement Model
- Supervisory Resources
- Systemically Important Institutions
- Drives financial levy

Engagement Level
- Minimum task frequency specified
- Risk Scoring Framework
- Key Business risks
- Control risks
- Not checklist: supervisory judgement
- Assessment of all H/MH Firms
- Spot checks on ML Firms

Assess Risk Probability
- Is risk above our risk appetite ?
- Our risk appetite isn't zero
- We ought to mitigate risks which are medium high or high probability
- Engagement intensification resulting from assessment

Internal Challenge
- Risk Governance Panels
- Risk Division
- Senior Management Review
- Supervisory Risk Co.

Risk Mitigation Plan
- Mitigation required for all major risks
- Does mitigation deliver conclusive result?
- Tracking MI

PRISM: Impact distribution of firms by sector as of September 2012

	High	Medium High	Medium Low	Low	Total
Retail Banks	5	3		1	**9**
International Banks	2	9	18	33	**62**
Credit Unions		20	248	133	**401**
Domestic Insurers	10	4	7	5	**26**
International Insurers	3	20	75	144	**242**
Stockbrokers		6	3		**9**
Mifid Firms	1	5	40	92	**138**
Pmt. Institutions / Bur. De Change / Money Transmitters		1		34	**35**
Trustee & Administration Firms		5	24	51	**80**
UN+CITs / Non UCITs / SMICs			14	163	**177**
Funds				4,935	**4,935**
Intermediaries				3,767	**3,767**
Totals	**21**	**73**	**429**	**9,358**	**9,881**

Group companies counted only once in above totals

The Supervisory Process

Step 1: PRISM determines the impact rating of the entity

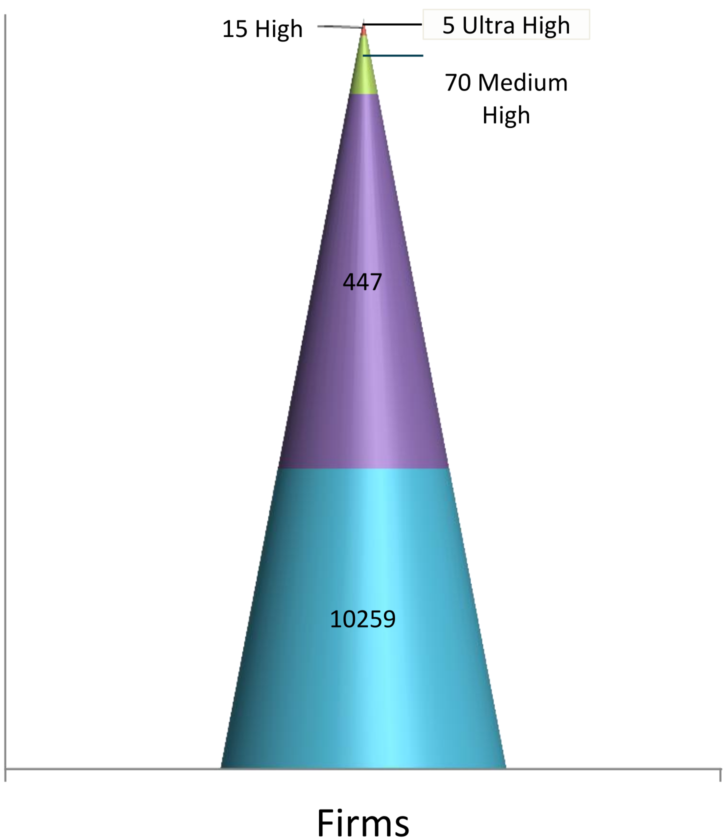
Step 2: The impact rating determines the number of staff allocated to that institution and the nature and frequency of the programme of work undertaken

PRISM IMPACT RATINGS

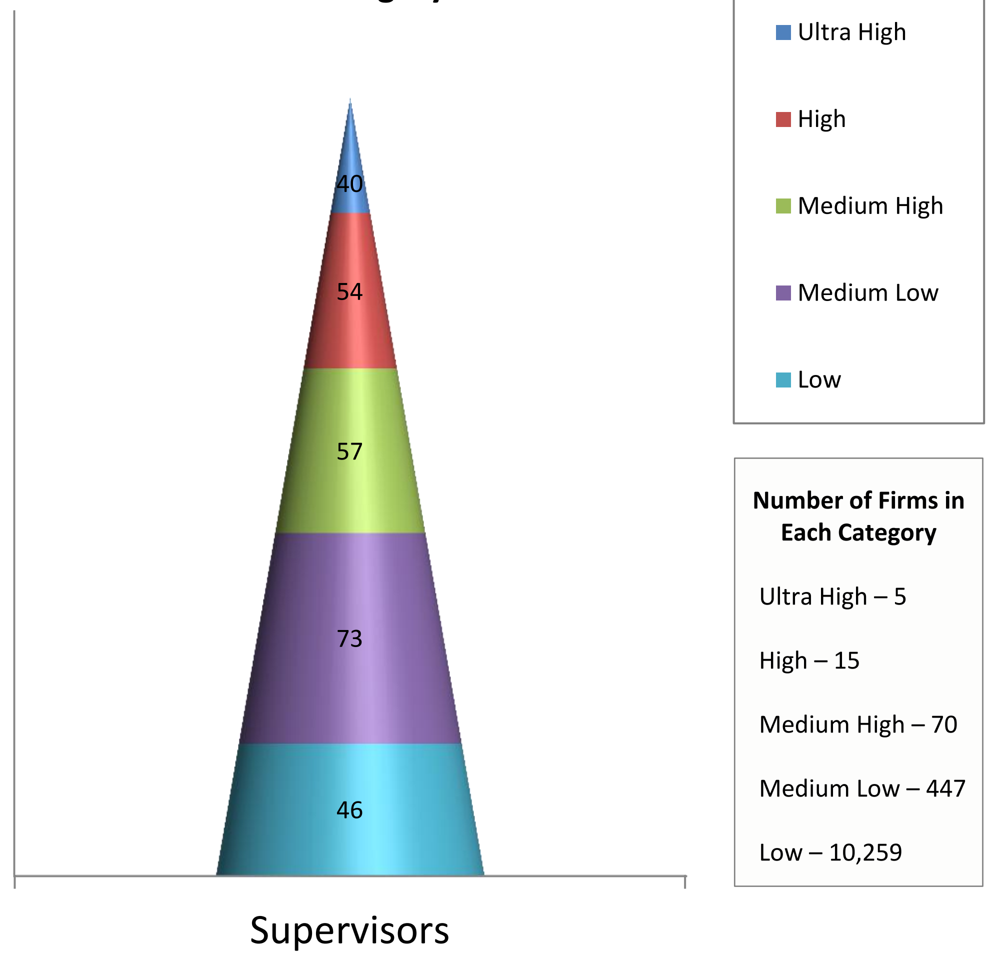
PRISM Impact rating	Insurance	Banking	Credit Unions	Full Risk Assessment?
Ultra-high	1	4		Continuous
High	12	3		Continuous
Med-high	24	12	20	Every 2 - 4yrs
Med-low	82	18	248	As required
Branches	149	34	133	No
Total	**268**	**71**	**401**	

PRISM: Distribution of firms and supervisors by impact category

Number of Firms per Impact Category



Number of Supervisors per Impact Category



Number of Firms in Each Category

Ultra High – 5

High – 15

Medium High – 70

Medium Low – 447

Low – 10,259

Unsurprisingly Enforcement has proved contentious

- Enforcement is an important tool for accountability, deterrence and raising standards
- Reputational damage is what makes it effective
- Supervisory teams decide whether a matter is sent to enforcement
- CB is transparent about its enforcement strategy and priorities
- Enforcement Strategy key elements:
  - Prudential: Systems & Controls
  - Consumer Issues & AML
  - Strong enforcement against lower impact firms

Overview

Numbers Employed:	2010	2011
Reinsurance	330	402
Life	4,970	4,349
Non-Life	5,650	5,354
Total	10,950	10,105

Key Balance Sheet Statistics as at 31 Dec 2011	
Total Assets	€237bn
Total bank bonds & deposits	€15bn
Total Sovereign bonds	€34bn
Total Irish Sovereigns	€2bn
Total Shareholder’s equity	€ 24bn

There has been a reasonably significant drop in number of firms in last two years

Number of Firms Regulated in Ireland

	2008	2009	2010	2011	Sept 2012
Reinsurance	119	119	115	102	90
Life	60	59	59	62	61
Non-Life	134	129	124	121	116
Total	313	307	298	285	267

Number of licences revoked

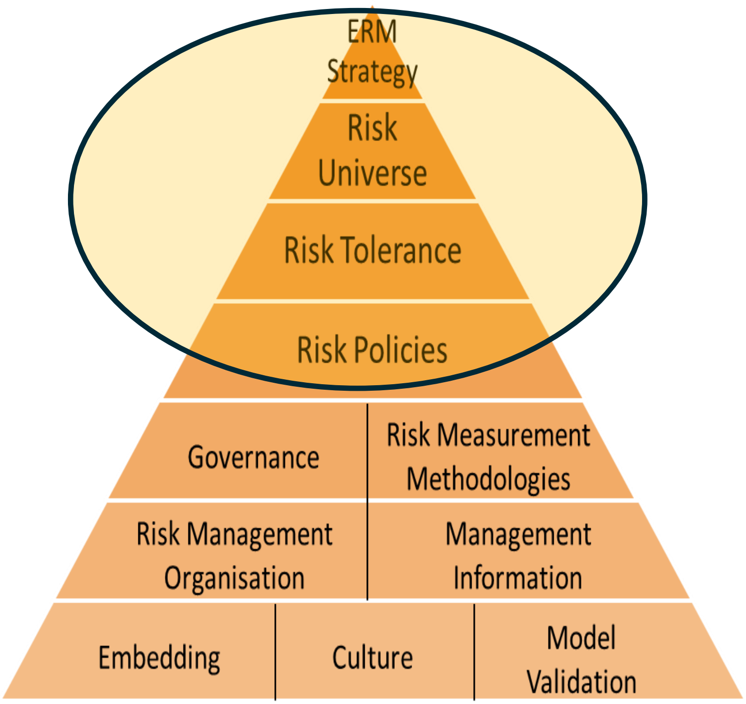
	2010	2011	2012	Total
All Company Revocations	**14**	**23**	**20**	**57**
Due to: Run off completed	10	9	9	28
Company Restructured	1	5	8	14
80/20 Rule Relaxation	1	4	3	8
Regulatory Costs	2	5	0	7

Both life & non-life sectors face continuing economic & operating challenges

Shared Challenges	
1	Economic conditions, declining business volumes Life: expense risk, lapse risk. Non-life: falling insured values and number of policies
2	Low interest rate conditions coupled with poor demand may lead to a stretch for yield in investment portfolio
3	Gender directive changes pricing and profitability models. Increases uncertainty over a key insurance challenge: namely, the 'cost of goods sold' is not known for many years
4	Absence of certainty in Regulatory Regime (Solvency II delays)

Life		Non-Life	
1	Low interest rates for a sustained period continues to be very challenging particularly for VA writers. Economic viability of product in doubt	1	Domestic demand is expected to decline further next year, albeit at a slower pace. Fewer customers and falling insured values
2	Government fiscal policy changes have dis-incentivised pension savings	2	Historically claims are higher during a recessionary period
3	Increased competition for "new" business: aggressive pricing levels	3	Insurers are more reliant on positive underwriting results to achieve returns. However, the market remains very competitive and companies may be tempted to take on additional risk in order to achieve top line growth
4	Irish business: dislocation in market; 2 largest companies effectively still 'in play'	4	Growth through market expansion carries specific risks. It is vital to fully understand the market

ERM Strategy & the Risk Appetite Framework is set from the top



Risk strategy:

- Defines how the risk management strategy supports the business strategy & plans: There must be a link!
- Should specifically set out the vision & values and serve as a guide to the management of risk

Risk appetite and tolerances:

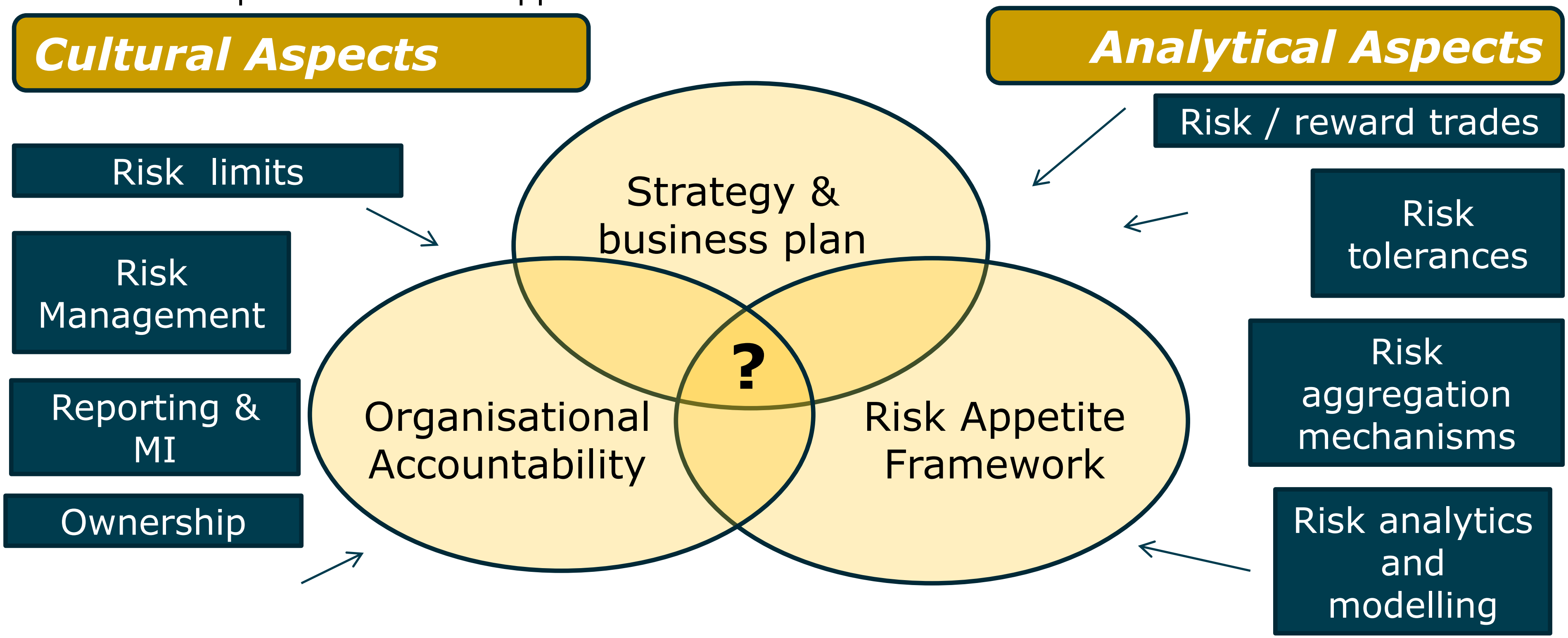
- Risk Appetite Statement establishes the risk metrics and risk agenda of the organisation
- Recognises that insurance is a risk transfer business and hence links risk & return
- Should include a description of types and quantities of risk the company is willing to take
- Risk appetites, tolerances & limits should have regard to and balance the expectations of all key stakeholders
- Must be consistent with Budgets and Business plans

Risk management policies:

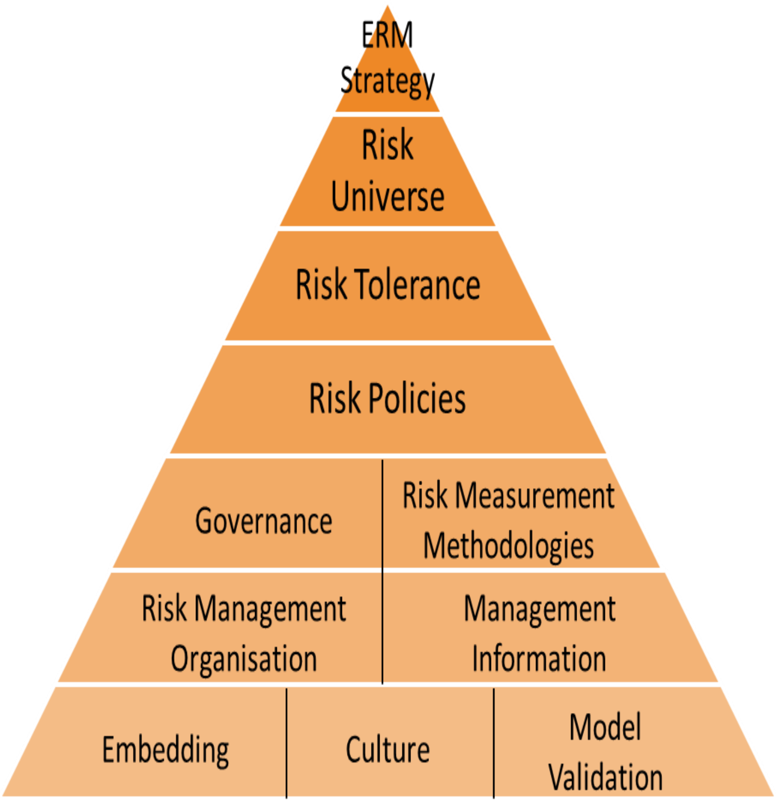
- Documents the approach to the management of each material category of risk
- Should lead to an integration of risk preferences and a risk context for decision making at all levels

Practically the ERM Framework should contain certain key components & must overlap other critical board responsibilities

- The firm's risk strategy
- What the firm is seeking to achieve within its risk appetite
- How the ERM strategy informs and interlinks with other key business processes and decisions (e.g. business plan, strategy, culture)
- How compliance with risk appetite can be monitored and evidenced



The Board should carefully consider the Risk Governance Operating Model to ensure explicit ownership of risk and allocation of responsibility



Day to day management of risks:

- Risk Owners clearly identified & managing in accordance with policies adopted by the Board

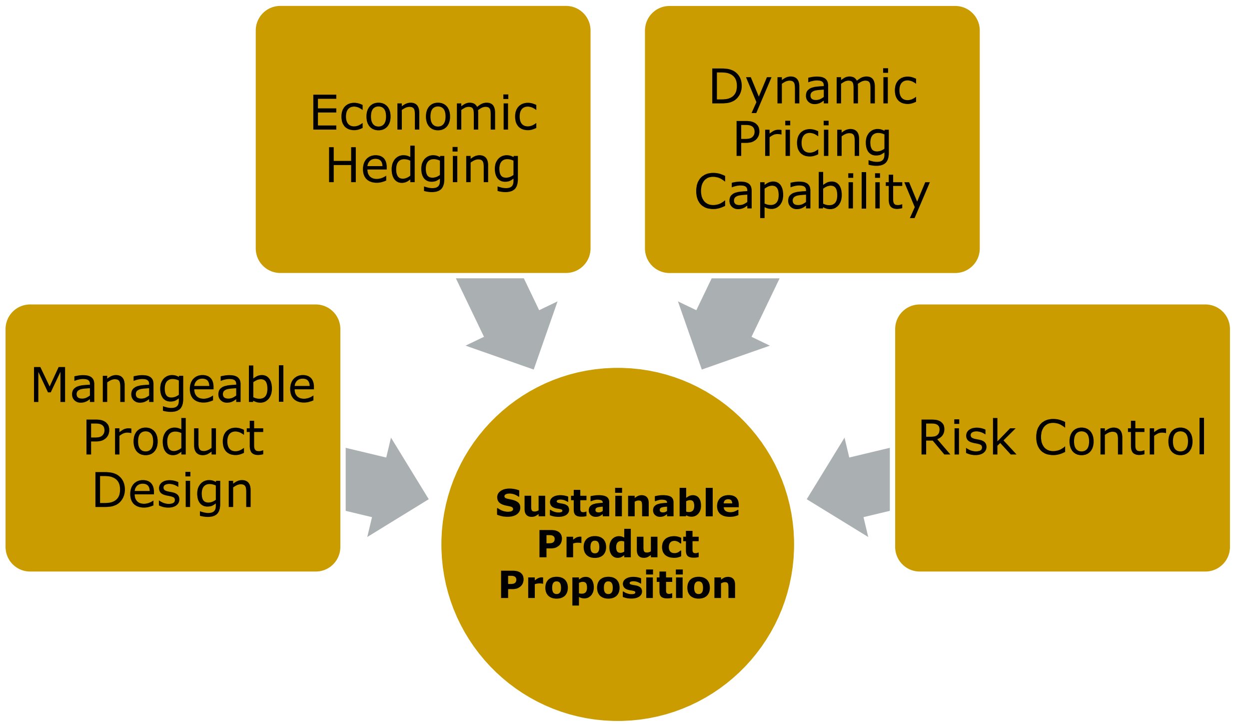
Oversight and challenge:

- Oversight function with responsibility for the day to day management, control and reporting of risks
- Oversight function is independent of management and staff with responsibility for originating risk exposures
- The Board Risk Committee has delegated authority in respect of risk identification, aggregation, assessment, measurement, monitoring and control

Independent assurance:

- The Audit Committee provides independent assurance on the overall system of internal control (including risk management and compliance)
- Internal Audit is independent of both origination and risk management functions and had ready access to the Audit Committee

ERM in Action



Use of a single, centralised platform

What is CBI looking for? Primarily for policies and statements in actual use…

Governance & oversight	- Board demonstrates risk awareness and knowledge of ERM best practice - Risk Appetite calculations should be reviewed with Board regularly. Risk appetite statements 'living documents' and regularly re-examined by Risk Committee - Strategic decisions (e.g., M&A, budgets, entrance into new businesses and markets, etc.) are examined from an ERM perspective and for consistency with risk appetite framework - Board ensures performance assessment and remuneration is consistent with risk appetite - Sources senior executive candidates with a strong ERM mindset - In a world of cost consciousness champion adequate resourcing of the Risk function
Prudent and robust reserving methodologies	
Emerging Risks	- Establishes processes & discussion to enable understanding and early identification of emerging risks – obesity, claims inflation, global warming, identity theft, low interest rate environment, etc
Strategic Risk Management	- Uses Reverse Stress / Scenario Testing / What If analysis to challenge accepted wisdoms - Uses ERM to help identify strategic business opportunities and to exit low margin business lines
Economic Capital Modeling	- Uses models & risk analytics for profitability (RAROC), potential M&A situations, budgeting, reinsurance purchasing, capital allocation, compensation etc

Some feedback & observations so far

- Much progress in the governance & operation of the risk committee
- Form improving; but as expected, substance has a ways to go
- Risk appetite statements are generally disappointing/not adequate (marginally better in Insurance than Banking)
- Culture of challenge must be nurtured
- Skills / knowledge / experience deficit in a small country continues to be a challenge
- Domestic & Non-domestic differences exist
  - "Strategy-Taker"
  - "Parental Controls"
- Responses to RMP sometimes address letter not the spirit of the issue
- INED's are important 'champions' & 'risk culture-makers'
- Successful Enterprise Risk Management is a journey not an end-point!

Thank you