



Insurers risk intelligence: New insights and opportunities for risk management



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Foreword

Dear Colleague,

As this paper goes to press, the global economy is facing mounting challenges. The insurance industry has not been immune to these challenges and is experiencing losses and declines in market value that few believed possible a year ago.

Many insurance companies have dedicated significant resources to building their risk management programs in recent years. However, the losses and declines in market value associated with the recent economic environment have revealed new insights about the complexity of risk, such as the increase in systemic risk and interconnectedness between financial risk and risk embedded in insurance products. We believe the current economic environment and the insights that are emerging from it offer opportunities for companies to improve risk management capabilities.

The challenges facing the industry are also likely to create the possibility of new risk management-related insurance regulation in the U.S. and increased scrutiny on companies' risk management practices by rating agencies and investors. In consideration of this possibility, we believe it would be appropriate for companies to examine some of the potential reactions that may arise from these external stakeholders when improving risk management capabilities.

This paper uses the current challenges of the insurance industry as a backdrop to provide insights on opportunities regarding risk management capabilities and what actions insurance companies may want to consider in their quest to become truly Risk Intelligent Enterprises™.

Sincerely,



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New insights for risk management and actions to consider

The current economic environment is impacting virtually all financial services industry sectors, including insurance companies. While past periods of significant losses within the insurance industry have largely involved underwriting losses, the current economic environment is notable in that losses are occurring on both the underwriting and asset side of the business. As the nature of these losses and their significance to the insurance industry are beginning to be understood, new insights have started to surface regarding the complexity of the industry's risk exposures and the opportunities to enhance risk management practices¹.

We want to debunk the notion that the challenges facing the insurance industry are evidence that enterprise risk management (ERM) does not work. Instead, we believe the current environment offers a unique opportunity for companies to take a fresh look at their risk management program and focus on developing capabilities that place risk management as an integral part of both strategy setting and day-to-day business where decision makers can look at risk and return together in an effort to improve their risk intelligence.

We also believe the impact on the insurance industry will create the possibility of increased risk management-related insurance regulation in the U.S. as well as increased scrutiny on companies' risk management practices by rating agencies and investors. This potential regulation and increased scrutiny will heighten the need for companies to consider many of the actions regarding risk management capabilities presented in this paper.

Questions are being asked about what insurance companies should do to evaluate their ERM practices and enhance the effectiveness of their risk management capabilities. The answers to those questions generally fall into the following four areas:

1. Risk governance and risk oversight
2. Building increased capabilities around risk identification, measurement, monitoring, and control
3. Embedding both risk and return into decision making
4. Communication, transparency, and disclosure

Although ERM leading practices will continue to evolve over time, we view these four areas to be relevant for ERM programs both today and in the future. In the following pages, we present new insights regarding risk management and specific actions companies may want to consider within each of these four basic categories. Because ERM is not a one size fits all proposition, the application of these actions within companies will vary based on a variety of considerations, such as size of the organization, organizational structure, maturity of existing risk management practices, product complexity, business strategy, and other factors.

We want to debunk the notion that the challenges facing the insurance industry are evidence that ERM does not work

Governance and oversight

New insights

The extensive challenges facing the insurance industry have highlighted the importance of senior management's and the board's role in risk management oversight. This awareness has created new insights about the potential benefits of enhancing risk oversight, risk governance, and associated risk management policies and procedures to increase senior management and board engagement, and to keep them both informed of the significance of the risks being taken.

In particular, identifying emerging risk issues, establishing appropriate risk reporting to senior management and the board, developing a clearly articulated and understood risk appetite and establishing linkages to risk tolerances for risk taking activities now appear to be much more important than ever before to help support the risk management oversight function.

Another key governance-related insight involves the role of the Chief Risk Officer (CRO). While the CRO position has been widely adopted by the insurance industry, its function within companies is relatively new and its authority level largely underdeveloped, particularly in relation to other key C-Suite positions. For example, the reporting line of the CRO in most insurance companies is to the Chief Financial Officer (CFO), not the Chief Executive Officer (CEO).

Additionally, for many companies that have CRO's within business units and at the corporate level, reporting lines for business unit CRO's appear to be predominantly within the business units instead of to the corporate risk function. Reporting lines for the CRO to the CEO and reporting lines for business unit CRO's to the corporate CRO may be appropriate to promote the proper authority level and oversight role of risk management.

Actions to consider:

1. Establish or modify board and management level risk committees to provide oversight and guidance to the risk management function, which should be documented in the relevant committee charters and risk policy.
2. Create or modify management level committees and risk policies to address the key risk areas, such as underwriting risk, market risk, credit risk, liquidity risk, and operational risk.
3. Create CRO access to the board and include regularly occurring board sessions with the CRO without management present, and other access to risk management, in order to be kept apprised of risk management activity and key risk issues.
4. Establish or modify overall responsibility for risk management so that it resides with the CEO with a direct CRO report to provide leadership and execution of the risk management function.
5. Create the authority for the CRO to have certain veto powers over transactions, use of counterparties, and other risk-related decisions with an appropriate escalation and resolution process.
6. Establish or modify the CRO function so that it is independent of the business units (and key business functions that may be conducted at the corporate level, such as investment management and reinsurance), and serves as a trusted partner to provide risk oversight and management functions so that the business can make more risk intelligent decisions.
7. Structure risk management organization functions, such as ERM, compliance and internal audit to operate in an integrated fashion across business units and risk categories, rather than operate in silos so these functions can collectively provide a true enterprise-wide risk management function.
8. Establish responsibility and accountability of the businesses (including key business functions that may be conducted at the corporate level) as a matter of policy, for taking and managing their risks with the risk management function providing risk appetite, tolerances, and limits to monitor, report, and measure risk exposures.

Risk identification, measurement, monitoring, and control

New insights

Although most companies have formal risk identification and measurement processes in place, there are new insights about the potential benefits associated with applying those processes to unknown or emerging risks and using that information for improved business decision making.

The potential benefits associated with improving risk identification and measurement capabilities can be created by embedding companies' risk management processes conducted by operating units and senior management, into the business as an integral part of strategy. Potential benefits can also be created by reorienting the emphasis of risk management processes to be more forward looking to adequately identify and assess previously unknown or hidden risks.

Another key insight is the value associated with developing risk measurement capabilities (whereby risk and returns can be viewed jointly to measure performance and support decision making within the businesses) is even greater than previously thought. This insight has highlighted specific areas that companies could address to enhance the identification and understanding of exposures, particularly as they relate to linkages and interconnectedness of counterparties, investment vehicles, and insurance products.

Additionally, it has become clear that potential benefits can be created by modifying the use of analytical models and increasing the level of judgment in the modeling process. This judgment could reflect professional opinions about the potential for extreme losses, the magnitude of which might not be addressed in the absence of such opinions, but nonetheless could be related to the various products being offered or other risks taken. For insurance companies, this issue largely relates to both formal product risk assessment policies and procedures and underlying models to adequately address the relationships between financial risk exposures and insurance product risk behavior under extreme event scenarios. Examples of how the use of models can be changed are:

- Improving back testing, stress testing, and scenario analysis processes to incorporate events that are hard to predict and rare beyond the realm of normal expectations of extreme;
- Balancing historical data and risk measures, such as VaR, TVaR, and CTE by supplementing historical data with business judgment and qualitative scenarios;
- Developing risk metrics and related applications for those metrics that incorporate potential loss outcomes that are less extreme than tail event losses so that a more comprehensive understanding of the risk profile can be created and communicated;
- Placing a greater emphasis on modeling liquidity risk;
- Improving the identification and measurement of risk, correlation and concentration risk, such as annuity guarantees, Directors & Officers (D&O), Professional Liability and the possibility of Fiduciary Liability, Surety, and Workers Compensation losses attributable to extreme events.

Actions to consider

1. Develop a continuous emerging risk management process to be conducted on a formal basis, expanding the company's view of risk to include exposures not previously considered. Such exposures are new forms of systemic risk, regulatory risk, contingent risks, correlation, and concentration risk. Incorporate this consideration of risk into stress testing and scenario analysis to build a more robust and enterprise-wide view of the company's risk profile.
2. Develop and maintain a consistent approach for risk identification and measurement, data management, models, and processes, such as stress testing, back-testing, and incorporating scenario analysis. Implement these processes to create an enterprise wide-view of risk necessary for the calculation of reliable risk metrics to support decision making.
3. Include liquidity risk management as a core risk management function along with underwriting, market, credit, and operational risk to address the growing contribution of liquidity risk to a company's risk profile.
4. Develop product risk assessment policies and procedures, particularly for complex products, led by risk management, so they can be incorporated into the product approval process and provide for the evaluation, measurement, monitoring, and control of the various risk exposures associated with new products, including the linkage between market, credit, and liquidity risks to underwriting risk.
5. Develop and implement a scaleable ERM technology platform to provide for the management of various forms of data, risk engines, and risk processes. The platform must be able to accommodate organizational growth and the increasing complexity of risk.

Although most companies have formal risk identification and measurement processes in place, there are new insights about the potential benefits associated with applying those processes

Embedding risk and return into decision making

New insights

Current market conditions have highlighted the need for improved capabilities to understand and act upon risk exposures, such as those considered to have contributed to underwriting losses and declines in market values of assets. The recognition for these improvements is driven by a more fundamental need for companies to integrate both risk and returns into running the business so that risk levels relative to return can be recognized and appropriately acted upon.

For many insurance companies, the integration of risk management information, created by methods and processes driven by the corporate risk function into the business in a risk-adjusted return context to measure performance and support decision making, has not fully matured. Part of this issue stems from the challenge associated with achieving a consensus within management ranks and the board about the appropriate balance of risk and return given the nature of the business and strategy. While risk management within the business has been a traditional hallmark for insurance companies, these practices have largely related to traditional underwriting and actuarial risk disciplines and continue to focus on measures, such as loss ratios, leverage ratios, combined ratios, reserve levels, and other basic financial-related ratios.

Improvements in this area will likely require regularly occurring formal venues for robust discussions between risk management, business units, and senior management and the board regarding the potential impact of risk on the business. Opportunities exist at many companies to improve the ability to bring risk concerns to the highest level of the organization to prevent or mitigate losses arising from significant events. For example, appropriate escalation procedures can be developed or used more readily so that relevant risk information about the extraordinary nature of an extreme or unusual event or beliefs about potentially significant risk can be adequately communicated to the CRO, senior management, and the board.

Actions to consider:

1. Develop a process of establishing how returns and risk will be balanced and stated by senior management with input and approval from the board, including risk appetite and the associated set of risk tolerances and limits.
2. Create clear information and guidance from senior management for business units and key corporate business functions, such as investment management and reinsurance regarding risk tolerance and risk limits and how they relate to the company's risk appetite.
3. Link compensation for risk personnel to performance on key risk management goals, and link compensation for all personnel to risk-adjusted performance metrics. Create and review incentive compensation programs to determine that they drive the desired behavior for all personnel in regards to risk management.
4. Develop a process whereby risk management provides input into the calculation of risk-adjusted performance metrics, which are measured and monitored independently of risk management and the business.
5. Develop and implement policies and procedures to incorporate analysis of risk-adjusted results against plan with senior management and the board, as well as regularly occurring discussions by the CRO and CEO with the board regarding risk and returns.

Communication, transparency, and disclosure

New insights:

The opportunities and potential benefits associated with bringing essential risk-related information to the right levels of the organization has been mentioned previously. In addition to opportunities to improve risk governance, risk identification and measurement capabilities, and integrating risk and return considerations into the business, there are new insights about how companies can enhance internal and external reporting of risk-related information. For example, at some companies, multiple risk frameworks, such as ERM, compliance, and internal audit operate in silos. The siloed nature of these risk functions create risk information that is often not aligned and of varying quality, and as a result, is difficult for senior management and the board to assess comparatively. Moreover, a misalignment of these risk functions can be confusing and burdensome for business units, which can be counterproductive to the creation of an effective risk culture and take valuable time away from day-to-day business responsibilities.

Events contributing to the current economic situation create new insights about opportunities for improvements in risk monitoring and reporting functions to create actionable risk-related information to be communicated more effectively to senior management and the board. For example, increasing the level of actionable risk-related information for the board to support their role of risk management oversight can help drive necessary follow through of essential risk management-related decisions.

Given the number of insights related to internal communication of risk-related information, it is not surprising that there are also opportunities for improvements in external risk disclosures as might be required in the future by regulators, rating agencies, and shareholders. The potential emergence of new risk-related information and other requirements from these external stakeholders are discussed in the following section of this paper.

Actions to consider:

1. Develop and communicate risk information related to strategy and key business decisions to senior management and appropriate board and management committees on a regular basis. Such information might include current and potential risk exposures, stress scenario results, correlations, risk concentrations, contingent exposures, and associated capital requirements.
2. Restructure or realign key risk functions associated with ERM, compliance, and internal audit to minimize the information and resource burden on the business units and improve the effectiveness and value of risk information reported to senior management and the board.
3. Develop clear and regularly utilized communication channels between senior management, the risk management function, internal audit, risk owners, and business unit management regarding risk policies and expectations for compliance.
4. Develop a protocol for communicating contingent and emerging risk exposures to senior management so they can be kept informed of major developments concerning the company's risks, especially during periods of stress.
5. Develop and implement CRO sponsored workshops and web-based training related to the firm's risk exposures, topical issues in risk management, and risk management processes so they can be made available to personnel, senior management, and members of the board, as appropriate.
6. Develop clear, concise, and easy to understand risk-related information for external stakeholders, such as shareholders, rating agencies, and regulators who are likely to increase their risk-related disclosure requirements in the near future.

Potential response from regulators, rating agencies, and investors

The events associated with the current economic climate and the magnitude of its impact has taken the industry by surprise and regulators, rating agencies, and investors are no exception. We believe that the current economic situation and its impact on the industry will create increased risk management-related regulatory requirements as well as increased scrutiny on companies' risk management practices from rating agencies and investors.

At this time, the amount and form of regulation and scrutiny from other external stakeholders that will ultimately arise is unknown. However, we believe there is the potential for such activity to have a material impact on companies risk management activities. In consideration of this potential, we believe it would be appropriate for companies to examine some of the reactions that may arise from these external stakeholders.

Regulators

The decades-old debate over federal versus state regulation has moved to the forefront as a result of the current economic environment, and as a consequence, the future structure of the U.S. insurance regulatory system is, at this time, very much an open question. Therefore, predictions of what requirements regulators may impose on the insurance industry with regard to risk management are speculative at this juncture. However, as a general matter, we believe that some form of regulatory change and reform is inevitable.

Many observers believe that Congress and the Obama administration will create a federal role for regulating the U.S. insurance industry and that it will not be optional, as in the optional federal charter concept that has been debated in Congress over the past few years. Many believe this new federal role will take the form of a layer to be added to existing state-based insurance regulation. The prevailing thought is that issues, such as market and business conduct, solvency, and consumer advocacy will remain under the jurisdiction of the state regulators, while the new federal regulator will address systemic risk issues.

Regardless of where the line between state and federal regulation is drawn, the growing interest of regulators in the area of ERM is not expected to wane. State insurance regulators' attention to the assessment of insurance

companies' risks and risk management capabilities has been growing since Standard and Poor's introduced ERM as a separate major category of their analysis of insurers in October 2005, which was subsequently followed by A.M. Best's announcement of their approach to evaluating companies' ERM practices. As these events unfolded, the thinking was that rating agencies were leading the way with establishing ERM expectations for insurance companies and that the regulators would be sure to follow. This now appears to be the case.

ERM activities of insurance companies have been given new focus by state regulators and by the National Association of Insurance Commissioners (NAIC). Most recently at the NAIC, risk-focused policy development has centered on areas ranging from international accounting and solvency standards to insurers' use of ERM in the information technology space. Most notably, beginning in 2010, state examiners must begin using a revised risk-focused examination approach. The risk-focused revisions to the NAIC's Examiner's Handbook have been made mandatory through the NAIC state accreditation standards.

As a result of the current economic situation and the intense scrutiny on the financial services industry, it is clear that state regulators will be looking more closely at the insurance industry's risk management procedures going forward. One example of regulatory activity that has already emerged from the current environment is the "New York State Insurance Circular letter No. 25, *Financial Condition Stress Testing*," that requires every New York authorized insurer to have a scenario stress testing process in place as part of prudent management. The department intends to review those processes to discern how different economic scenarios are analyzed by senior management to determine what actions are warranted². In addition to the likelihood of emerging state-regulation around ERM, if a federal insurance regulator is created and charged with focusing on systemic risk, the industry can expect to have its risk management closely scrutinized on that level as well as on the state level.

It is worth noting that insurers in the UK and Switzerland have been operating under risk-related capital regulation. Additionally, insurers in those countries as well as in the broader European Union have largely started their readiness process to respond to the proposed Solvency II risk-based solvency directive which is currently targeted for implementation in 2012. Given the level of risk-related regulatory requirements impacting European insurers (including European subsidiaries of U.S. domestic insurers), it would be reasonable to expect a leveling effect associated with risk-related regulatory changes in the United States.

Increased regulatory requirements relating to companies' ERM practices are likely to be manifested in various forms. Regardless of the fate of state vs. federal regulation, from the standpoint of global competition, U.S. insurers should solidify their ERM programs. In anticipation of the potential for likely regulatory activity, companies should take this opportunity to evaluate their state of readiness. Companies may want to consider the following readiness activities, many of which relate to the "Actions to consider" in the previous sections of this paper.

1. Develop and strengthen ERM governance, policy, and practices throughout the company
2. Develop and utilize the company's ERM policy as a living, breathing part of the way business is conducted instead of a document on a shelf. A well-developed ERM framework can facilitate adaptation of the organization to new public policies that are expected to emerge.
3. Develop a regularly occurring communication protocol with regulators (at least annually), that includes ERM and other risk management processes, such as compliance and internal audit.

Rating agencies

Rating agencies have traditionally incorporated the assessment of insurance companies' risks and risk management capabilities into the rating process. This practice became more formalized with S&P introducing ERM as a separate major category of its analysis of insurers and reinsurers³ in October of 2005. In March of 2007, A.M. Best announced their position on ERM in the rating process:

"Whether utilizing a formalized ERM framework, integrating selected elements of ERM into an insurer's operating practices or relying solely on a traditional risk management process, A.M. Best perceives risk management as being paramount to an insurer's long-term success.....A.M. Best believes that assessing an insurer's risk management capabilities, within the context of determining an insurer's financial strength – should be viewed in light of a company's scope of operations and complexity of its business."⁴

This rating agency ERM activity has become a noticeably large driver of the insurance industry's risk management capabilities in the U.S. compared to regulatory influences, which have not been substantial.

The current financial environment has created the first real test for ERM programs. Research provided by S&P suggests a relationship between the relative strength of an ERM program, as rated by S&P, and the ability of a company to mitigate downward movements in net income and share price⁵. This relationship offers anecdotal evidence of the potential direction that rating agencies might go with introducing more rigor in their ERM assessments.

We believe rating agencies will be placing increased emphasis on insurer's ERM programs in the rating process for two reasons. First, data suggests the performance of insurance companies in the current economic environment may be at least partly related to their ERM capabilities. Second, rating agencies have begun to utilize the results of a company's ERM capabilities as a leading indicator of a company's ability to withstand stress brought on by losses. This belief is supported by a recent statement from A.M. Best whose position is that the current economic environment reinforces the need for enhanced ERM and in their view progress in this area should not be delayed⁶.

It is likely that rating agencies will continue to play an important role in the evaluation of insurer's risk management practices. Additionally, we expect that rating agency scrutiny is likely to increase.

Investors

Although the disclosures regarding a company's risks are important to investors, historically, investor attention to insurance company ERM practices has generally not been influential in driving the development of ERM capabilities. We believe this historical situation is likely to change as investors become increasingly aware of the potential connection between ERM capabilities, financial performance, and market value as greater attention is given to companies' ERM practices by regulators and rating agencies and as the general investor appetite for information grows to satisfy their needs for understanding an increasingly complex risk environment.

In addition to a growing investor awareness of the importance of ERM in the industry, there are specific investor needs that can be potentially satisfied with more in-depth knowledge of how insurers are managing their risks. One of these needs is related to the growing importance to investors of the fair value of credit as expressed by credit spreads. Although there are many drivers of credit spreads for a particular company, one of them is arguably a company's ability to utilize risk management practices to help drive the business and provide a tactical means to help support strategy.

Another need for information is related to insurer's capital-raising activities. Such activities (which may increase in the near future if needs to restore capital levels increase) are likely to more often require ERM-related information for investors to gain a better understanding of the relationship between a company's risk and risk management capabilities and their cost of credit and capital structure.

The potential for a growing use of risk information by investors may also be driven by the phenomena associated with the impact of significant events, such as those related to the current economic environment on the insurance industry. The impact of these events generally serves to simultaneously improve companies' risk and capital management capabilities as new opportunities for improvement become apparent, and increase the demand for risk-related information by various external parties, most notably rating agencies in the past few years. The evolution of risk and capital management methodology and tools, coupled with rating agency – and now regulatory – drivers, is creating a level of transparency between the connectedness of risk and capital that historically has not existed. This increase in transparency is creating a new source of information available for investors.

Important questions every board should consider

The risk oversight function requires a company's board to understand the key risks of the organization and determine that the proper risk management processes are in place for the company to maintain risk levels within its stated risk appetite. This responsibility requires the board to keep itself adequately informed of risk levels, which in light of the crisis' extraordinary impact on the insurance industry, has proven to be a challenge. As companies' boards look at the environment in 2010 and beyond, we believe every board member should consider asking the following key questions in an effort to enhance overall risk intelligence.

Oversight and reporting

- Are the risk oversight functions of the board committee with delegated risk oversight responsibility clearly defined in its charter?
- Are all relevant risk exposures appropriately aggregated into board and senior management risk reporting?
- Does the board understand the risk information it receives?
- Does the board understand what actions it should take in its oversight role if it receives adverse risk information?
- Does the board's risk committee have enough members with experience and understanding of risk management issues? Does their experience include multiple business cycles?
- Is there a defined and documented reporting line of the CRO to the CEO?

Roles and responsibilities

- Are the firm's policies and procedures clearly defined in writing? Do they include all major categories of risk, including risk governance and oversight as well as processes for managing each type of risk?
- Has the board reviewed and approved the risk appetite and key risk management policies? Does senior management review them on a periodic basis?
- Are the CRO and risk management supporting staff adequately compensated?

- Does the CRO have implicit or explicit authority to veto transactions and drive risk reduction as necessary?
- Does risk management systematically provide training to develop competencies around risk management and through different business unit levels?

Processes

- Are risk and return part of strategic discussions?
- Is the new business and new product approval process documented?
- What mechanisms exist to monitor compliance with policies?
- What procedures exist to identify new or emerging risks that may impact the company, and how is their potential impact assessed?
- Does risk management periodically conduct stress tests to evaluate the firm's sensitivity to tail risks and extreme, previously unforeseen events?
- Do board risk committees have regularly scheduled risk management review discussions?
- Does the board have regular communication with risk management, including:
 - In-person presentations and discussions with the CRO, including executive sessions without management present?
 - Regular reports showing key risks measured relative to their risk tolerances?

The Risk Intelligent Enterprise™

Insurance companies that are most effective and efficient in managing risk with respect to both the existing business as well as future growth, will in the long run, likely outperform those who are less so.

We believe insurance companies need to evolve from their current state of risk management and strive to become truly “Risk Intelligent Enterprise™”. This belief is predicated on the assertion that insurance companies that are most effective and efficient in managing risk with respect to both the existing business as well as to future growth, will in the long run, likely outperform those who are less so. While insurance companies generally regard their core business as risk management, we believe there are opportunities for improvement.

In our view, a Risk Intelligent Enterprise™ adopts a balanced perspective of risk management, supported by the following nine fundamental principles:

1. A common definition of risk, which addresses both value preservation and value creation, is used consistently throughout the organization.
2. A common risk framework, supported by appropriate standards, is used throughout the organization to manage risks.
3. Key roles, responsibilities, and authority relating to risk management are clearly defined and delineated within the organization.
4. A common risk management infrastructure is used to support the business units and functions in the performance of their risk responsibilities.
5. Governing bodies (e.g., boards, audit committees, etc.) have appropriate transparency and visibility into the organization’s risk management practices to discharge their responsibilities.

6. Executive management is charged with primary responsibility for designing, implementing, and maintaining an effective risk program.
7. Business units (departments, agencies, etc.) are responsible for the performance of their business and the management of risks they take within the risk framework established by executive management.
8. Certain functions (e.g., finance, legal, IT, HR, etc.) have a pervasive impact on the business and provide support to the business units as it relates to the organization’s risk program.
9. Certain functions (e.g., internal audit, risk management, compliance, etc.) provide objective assurance as well as monitor and report on the effectiveness of an organization’s risk program to governing bodies and executive management.

Conclusion

Strengthening risk management is everyone's job, beginning with a company's board. Insurance companies with strong risk management functions often use a "three pillar" strategy where business management, risk management, and the internal audit function reinforce overall attention to risk and control issues. Business units must take their own risk management role seriously and devote sufficient resources and management attention to make risk management effective.

Both the insurance industry and the world have a heightened awareness of the desire to adapt and enhance risk management practices as part of an effort to avoid major losses and drive enterprise value. However, this commitment to risk management must not be taken lightly and should not be a passing one that wanes when good times return. An ERM program is only as strong as its weakest link. It requires focused effort and significant resources across business cycles to create and maintain an effective risk infrastructure and drive risk culture that is critical to make risk management successful.

Endnotes

¹Risk management, used synonymously in this paper with the term enterprise risk management

² New York State Circular No. 25, November 18, 2008, State of New York Insurance Department-

³ Insurance Criteria: Evaluating The Enterprise Risk Management Practices of Insurance Companies, Standard & Poor's RatingsDirect®, October 17, 2005

⁴ Draft: Risk Management and The Rating Process for Insurance Companies, A.M. Best, March 5, 2007

⁵ For North American Insurers, Strong Risk Management And Capital Adequacy Are Key Defenses Against Recession, Standard & Poor's RatingsDirect®, December 12, 2008

⁶ Financial Turmoil Poses Real-Life Stress Test for Solvency II Directive: A.M. Best Research; January 26, 2009

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