



International Association for the
Study of Insurance Economics

Études et Dossiers

Extract from

Études et Dossiers No. 326

The Insurance Industry: Risk Governance and Solvency II

Milan, 28 November 2006

&

A Reputational Risk Management Framework

Report prepared for The Geneva Association
and Macros Research

by Dr. Riccardo Bigio

April 2007

Working Paper Series of The Geneva Association

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Layout & Distribution: Valéria Kozakova

Enterprise Risk Management in Insurance Companies: a UK perspective

Gerry Dickinson

Evolution of Risk Management in UK Insurance Companies

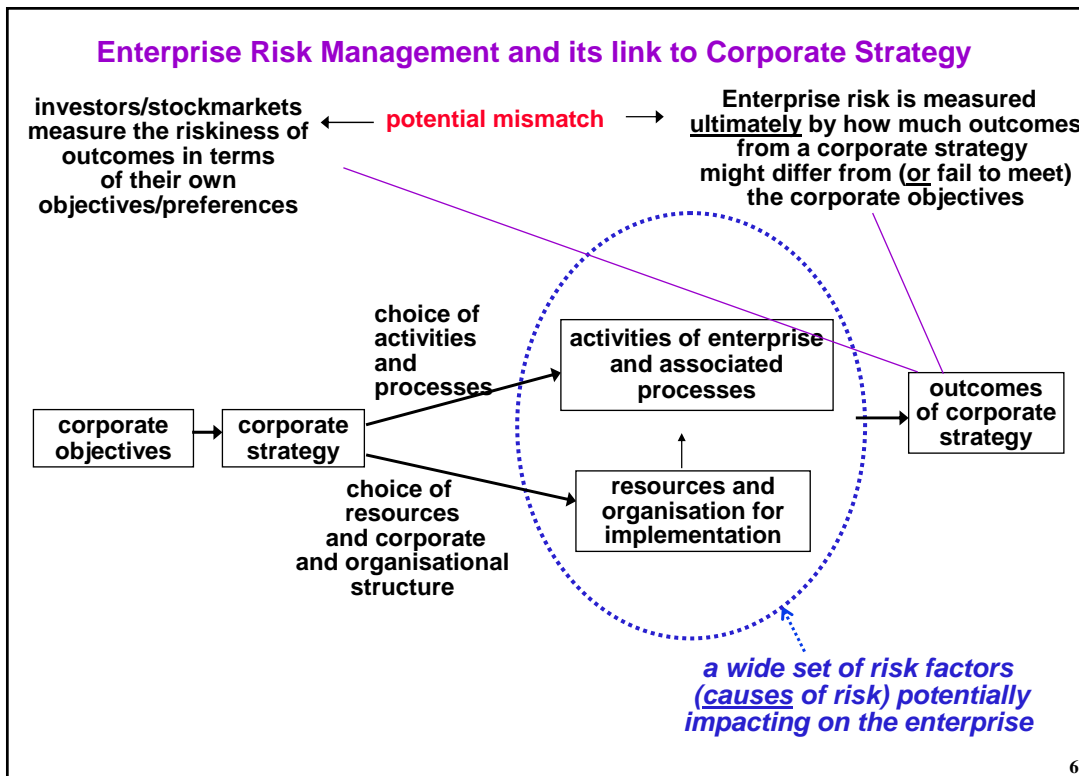
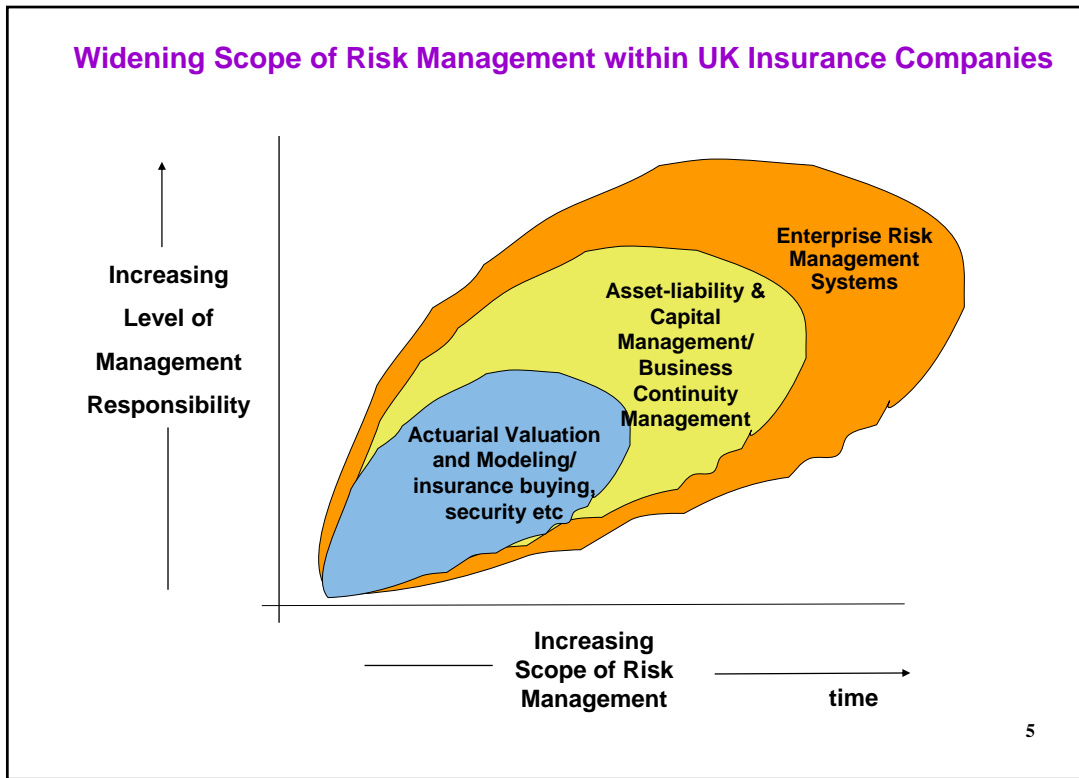
- 1950's** ● Actuarial models began to be developed in life insurance, Redington develops interest rate risk immunization model (1952).
 - Insurance companies begin to set systems to manage their own insurance risk needs (insurance and self-insurance).
- 1960's** ● Contingency planning gains a greater role in the general management of insurance companies.
 - Risk incorporated more in actuarial valuations in life insurance and product and pricing profit testing.
- 1970's** ● Greater risk modelling used in non-life insurance, mainly loss (claims) reserving models, risk factor models for motor insurance pricing, and for risk retention/risk transfer decisions.
 - Contingency planning develop into more business continuity management systems.

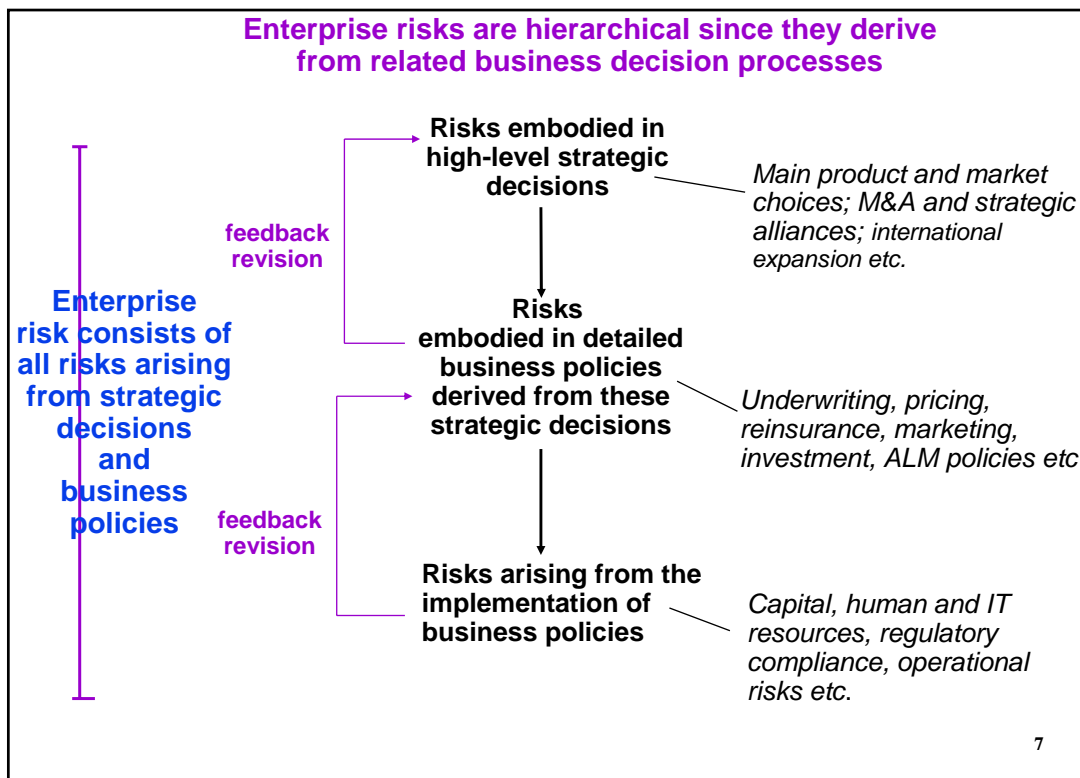
- 1980's ● With growth of financial derivatives, investment and treasury management departments begin to develop financial risk systems, within the constraints of insurance regulation.
- Theory of finance, including CAPM, APT and option pricing, begins to be incorporated into actuarial models in insurance.
- ALM models develop more in insurance, combining financial models used in banks with new actuarial approaches.
- 1990's ● Development of Geographical Information Systems (GIS) and computer modelling to assist measurement of impact of natural catastrophic hazards
- Aware of risk-based regulatory capital systems being introduced in United States and other countries, as they have overseas operations.
- Strategic planning models, based on creating economic value creation, incorporating risk explicitly.
- Enterprise Risk Management emerges, assisted by better computer modelling e.g. scenario analysis and risk mapping techniques. Top-down risk management models begin.

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- 2000 + ● Corporate governance standards require greater emphasis on enterprise risk management, with more responsibility being placed on Boards of Directors.
- UK insurance companies start to emphasise ALM and internal capital models, assisted by advances in stochastic modelling techniques, to improve their competitive efficiency.
- Senior managers are appointed to develop ALM and aspects of enterprise risk management. Boards of Directors, and their Audit Committees, focus more on enterprise risk management.
- Anticipation of new risk-based solvency and capital rules in UK by Financial Services Authority (FSA) in 2005, and future Solvency II, encourages more investment in ALM, internal capital models and enterprise risk management systems.

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- Main Factors behind the emergence of Enterprise Risk Management in UK**
- Greater responsibilities being imposed on Board of Directors by corporate governance standards (UK Combined Code on Corporate Governance for listed companies) and by UK supervisor, FSA.
 - Greater use of economic capital and value creation models in strategic planning by insurers, which explicitly include risk.
 - Managements anticipate new FSA regime and future Solvency II encouraging internal models for capital measurement (Pillar 1) and enterprise-wide risk management policy (Pillar 2).
 - Rating agencies (S&P, Fitch, Moody's and AM Best) look for at sound enterprise risk management system as a part of their rating assessments.
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Emergence of Enterprise Risk in Insurance in the UK

- **Enterprise Risk Management still an evolving management function, with the senior risk executives/CRO's appointed to develop and implement this new function. A recent development, only since 2001.**
- **During the last five years, senior managers have been appointed as heads of risk management in most leading UK insurers.**
- **These appointments are members of the senior management team at Head Office. But few are yet on the main board of directors or have responsibility for developing a full enterprise risk management policy.**
- **The Geneva Association, set up the CRO's Forum in 2003, for heads of risk management in leading European insurance companies, has been active and has allowed the sharing of ideas and experiences. Executives from leading UK insurers have been active in the Forum.**

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- **A current challenge is extending enterprise risk management across the world-wide group. Leading UK insurers are currently appointing risk management executives in overseas subsidiaries reporting directly to Head Office, and reporting to local CEO's and Boards of Directors.**

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Links between CRO, CEO and CFO and the Board of Directors

- Head of Risk/CRO reports to the Executive Management, but only a few report directly to the CEO, but this is likely to change.
- In only a few cases does the Head of Risk/CRO report directly to the Board of Directors, or the Audit Committee of Board.
- The rise of the CRO is causing a rethink of the responsibilities of the Chief Financial Officer (CFO)
- Driven by corporate governance issues and Solvency II, more responsibility and independence will be given to the CRO
Gradual trend for more CRO's to become executive directors.

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CRO/Head of Risk Management and External Relationships

Insurance Supervisors

- Responsibility of Head of Legal Department or Head of Compliance , with information support from the CRO.
- It is expected that there will be more prominent role for the CRO in dealing with insurance supervisory authority (FSA) under Solvency II

Rating Agencies

- Responsibility of CFO and/or Head of External Relations, but with information support from the CRO.
- A more prominent role for the CRO with rating agencies is likely, as CRO's are now closely involved in economic capital measurement/ ALM and developing new Enterprise Risk Management system.

External Auditors

- Responsibility of CFO, but with a greater support from CRO as more detailed disclosures in risk reports and in notes to financial statements required by new IFRS regime and corporate governance standards.

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