

**Casualty Actuarial Society In Focus: Elephants in the Room**

# Rating Agencies and Emerging Risks

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# Agenda

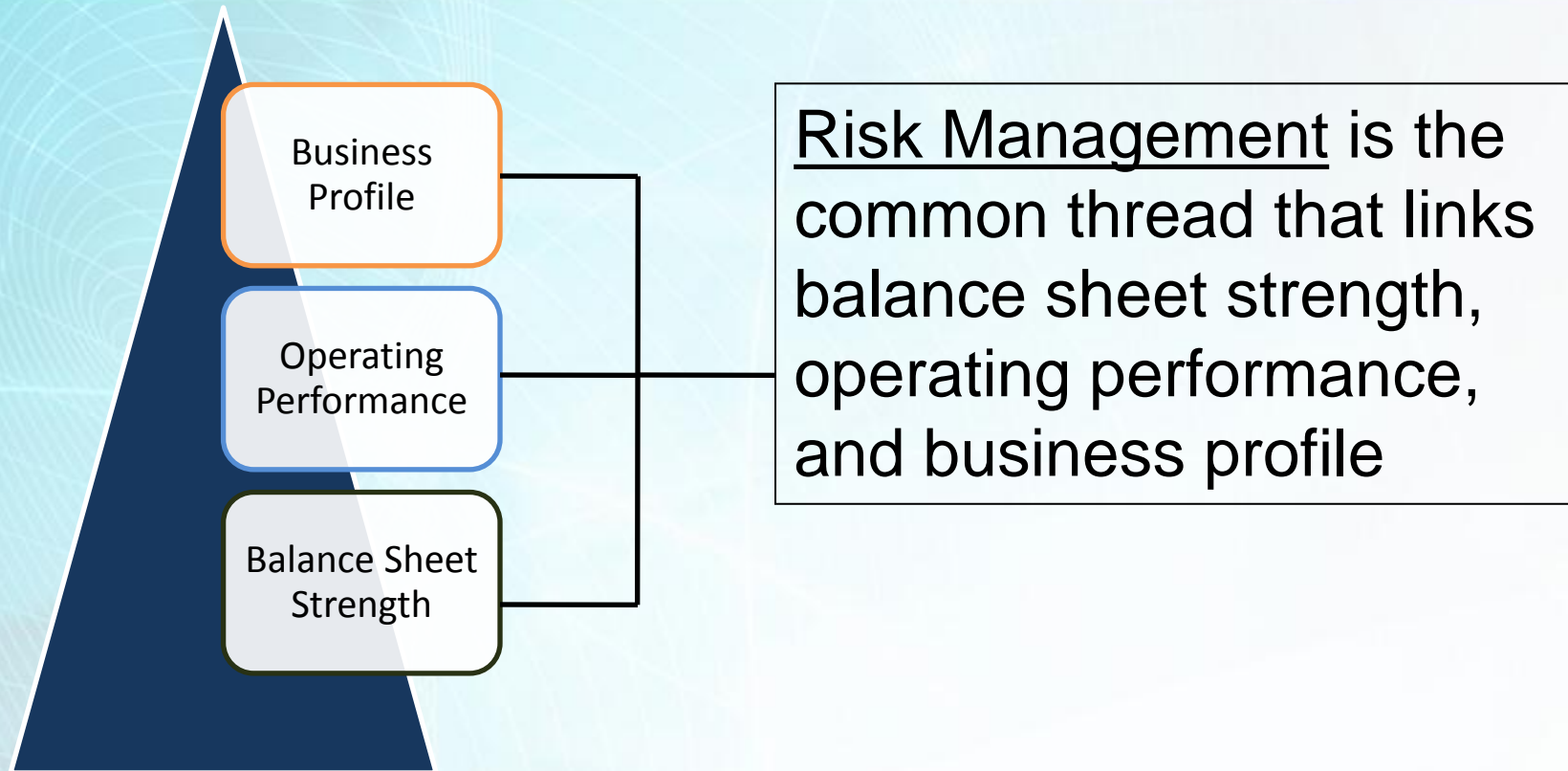


- Review of Risk Management Capability and Characteristics
- A.M. Best's Supplemental Rating Questionnaire
  - Responses To Emerging Risk Inquiry
- Impact of Emerging Risks in the Rating Process

# Risk Management Capability and Characteristics



# Risk Management in the Rating Evaluation Process

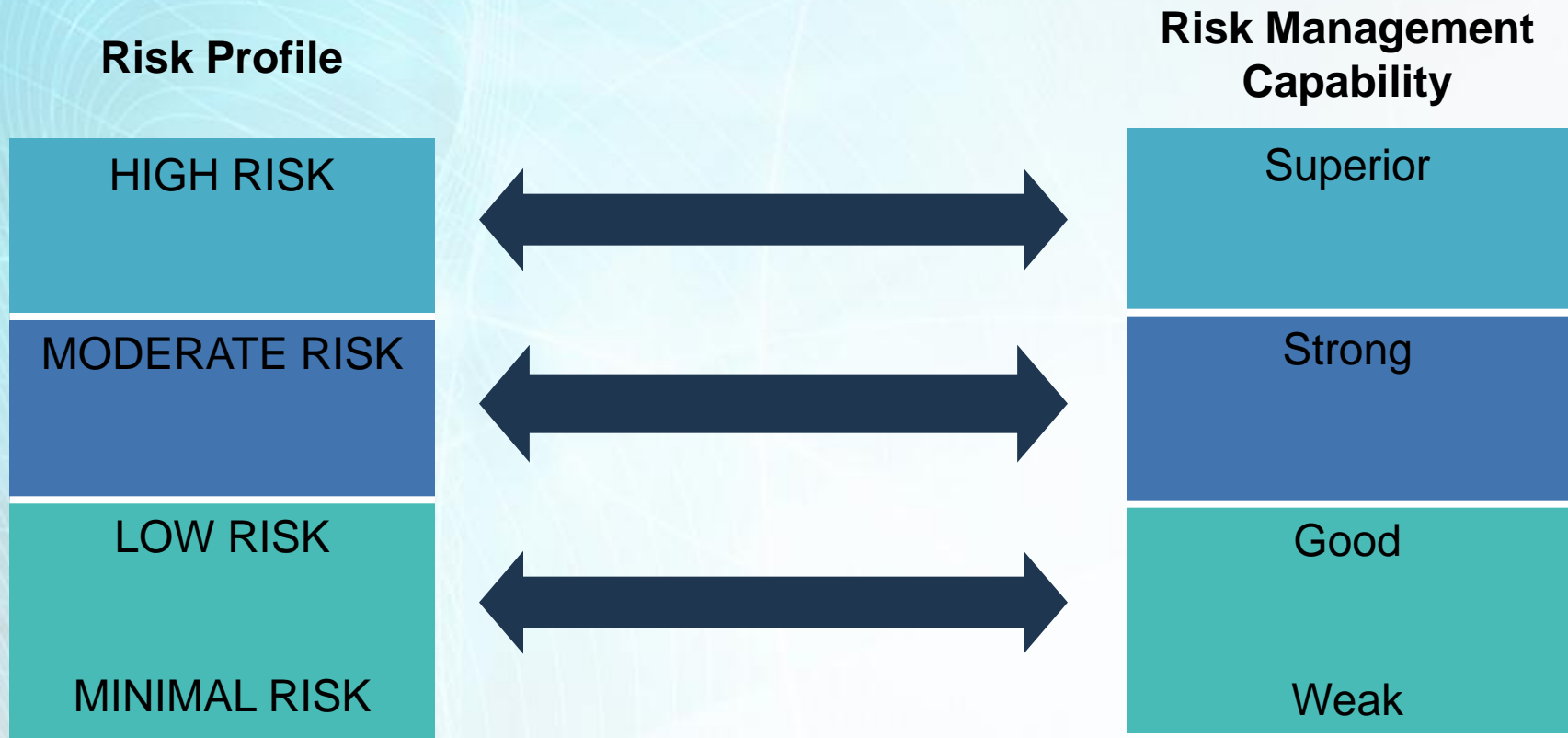


Risk Management = (Identify + Understand + Measure + Manage) Risk

# Risk Management



A company's risk management capability needs to meet its risk profile



# Risk Profile Characteristics



## Qualitative:

- Lines of Business
- Volatility
- Correlations
- Liquidity
- Policy Limits
- Product/Coverage Changes
- Competition
- Legislative/Regulatory Environment
- Judicial Environment
- Investments
- Financial Flexibility
- Economic Environment
- Concentration
- Data Quality
- Growth
- Reinsurance Credit Quality
- Ceded Leverage
- Impact of Reinsurance Program
- Management Philosophy

## Quantitative:

- Market Risk
- Credit Risk
- Underwriting Risk
- Off Balance Sheet Risk
- Operational Risk
- Strategic Risk
- Capital Management

# Emerging Risk Inquiries A.M. Best's Supplemental Rating Questionnaire



# Emerging Risks



- Emerging Risk Definition from Lloyds
  - “an issue that is perceived to be potentially significant but which may not be fully understood or allowed for in insurance terms and conditions, pricing, reserving, or capital setting.”
- Classic Emerging Risks
  - Natural Catastrophes
  - Class action lawsuits
  - Inflation or stagnation

# Results from SRQ Question 56k



- For 2012, A.M. Best added a specific question to the Supplemental Rating Questionnaire

56k. Please list the emerging risks that management has identified and is most concerned with because of the potential adverse financial impact that risk could have on the rating unit.

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

# Historical Emerging Risks



- Previously Recognized Emerging Risks
  - Terrorism and regulatory backstops
  - Energy supply interruptions from political instability
  - Weather and climate change – hurricanes, inland flooding, drought.
- Recently Developed Emerging Risks
  - Year 2008 economic events
  - U.S. Government default potential
  - Municipal default

# Results from SRQ Question 56k



- Review of the industry responses to Questions 56k show a variety of perceived emerging risks:
  - Cyber and data related risks
  - Social media
  - Patient Portability and Affordable Care Act
  - Fracking
- Risks not seen in the response:
  - Underwriting processes and procedures
  - Changing dynamics in claim frequency and severity trends



# Impact of Emerging Risks in the Rating Process

# Enterprise Risk Management Discussion with Company



- Risk identification process and findings
- Risk quantification and stress testing
- Risk tolerance determination
- Action plans and responsibilities
- Implementation and re-evaluation

# Enterprise Risk Management Discussion with Company



- Risk identification
  - Catastrophe exposures
  - Systemic loss or class action lawsuit exposures
  - Legal / regulatory / judicial susceptibility
  - Investment risk
  - Image / Reputation risk
  - Strategic business market risk

# Enterprise Risk Management Discussion with Company



- Opportunity identification
  - Value determination
  - Cost / benefit analysis
  - Operation risks
  - Aggregation risks
  - Threat or Opportunity
  - Weaknesses versus Strengths
  - Action steps



# Enterprise Risk Management Discussion with Company



- Quality and thoroughness of process
- Relevance to company
  - Address needs of insureds
  - Provide value added to retain business
  - Road map to growth and improved profitability
  - Improve return to owners
- Heat maps
- Capital models

# Enterprise Risk Management Discussion with Company



- Market leadership position
  - Threats from competition
  - Ability to maintain pricing discipline
  - Changing needs of insureds
  - New products
  - Image / reputation
    - Insureds
    - Regulators
    - General public

# Enterprise Risk Management Discussion with Company



- Risk tolerance
  - Underwriting
  - Investments
  - Competitive pressures
- Mitigation
  - Capitalization
  - Reduce risks
  - Reinsurance

# Enterprise Risk Management Discussion with Company



- Risk control action
  - Accept as is
  - Reduce risk
  - Eliminate risk
  - Diversify risk profile
- Follow up



# Enterprise Risk Management Discussion with Company



- Enhanced discussions
  - Relative to company profile and exposures
  - Levels of responsibility
- ERM is more than just risk management
  - Affects all areas of an organization
  - Responsive to all risks and opportunities that could have an impact on the strength, viability, and relevance of the organization

# Enterprise Risk Management Discussion with Company



- Awareness among staff, management
- Board of Director involvement and oversight
- Demonstrated utilization of ERM capability
  - Lessons learned
  - Improvements implemented
- Ability to identify opportunities
- Ability to address weaknesses to take advantage of opportunities

# Enterprise Risk Management Discussion with Company



- Ability to respond to adverse outcomes
  - Surplus protection
  - Set proper rates
  - Reinsurance – quality and dependence
- Business continuity
  - Disaster recovery
  - Off-site capabilities
  - Succession plans

# Enterprise Risk Management Discussion with Company



- Capital management
  - Individual units interacting with total group
  - Insurance / non-insurance units / investment risks
  - Internal dividend requirements / debt servicing
  - Explicit support / source of cash for corporation
  - Short term versus long term risks and needs
  - ALM strategy / impact on investments
  - Plans to maintain capital adequacy

# Common Questions



- Will the impact of an emerging risk on a company's operations or financial condition lead to a rating action?
- Will management's ability to recognize and act on emerging risks provide support for improvement in assigned ratings?
- Isn't recognizing emerging risks all part of cycle management anyway?



# Common Questions



Thank You

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