10 AÑOS

SUGESE

Superintendencia General de Seguros

República de Costa Rica

Risk Management

The Supervisor's Perspective

The Supervisory Approach

- Understanding risks faced by each insurance company
- Assessing those risks
- Assessing the quality of risk management at each insurance company – here I use a broad definition of risk management to include – Corporate Governance / Risk Governance / Risk Management / Oversight / Controls
- And, if the identified risks are not being managed appropriately – intervening to ensure that the necessary risk elements are modified as necessary – this being the pure or inherent risks or the management of the risks

Fundamental understanding for a risk based supervisory framework:

- An insurance company's Board of Directors and Senior Management are responsible for the management of the company and ultimately accountable for is ***Safety and Soundness***
- Effective supervision will reduce the risk the likelihood that an insurance company will fail but it is expressly recognized that insurance companies operate in a competitive environment and need to undertake reasonable risks

Boards of Directors

Approve and oversee the implementation of the insurer's business objectives and strategies	Oversight in respect of the design and implementation of sound risk management and internal controls
Approve risk strategy and appetite (tolerance)	Design remuneration policy that is aligned with the identified risk appetite
Ensure the necessary separation of management and oversight	Ensures the is a reliable financial reporting system
Appropriate mix to ensure adequate level of knowledge, skills, expertise	Ensures that there is appropriate and effective communication with the supervisor
Necessary ability to operate independently of management	Demonstrate the effectiveness its corporate governance framework
Act in best interests of the insurer and policy holders	

Risk Governance – Boards of Directors

Corporate governance

↳ Risk Governance

- Risk appetite framework
- Enterprise risk management
- Oversight
- Capital management / Own Risk and Solvency Assessment

Does this look familiar?

- Oh no, what does the supervisor want now?
- Darn – guess we have no choice but to do this
- Well, this is interesting – we did not know that
- We should have done this years ago – this makes a lot of sense

Adapted from presentation by A Campbell – Guarantee Company of North America

Risk Governance – Boards of Directors

Corporate governance

↳ Risk Governance

- Risk appetite framework
  - Establishes the goals, benchmarks, parameters and limits as to the amount of risk the company is willing to undertake
  - Provides boundaries on the on-going operations of the company
  - Understood throughout the organization and embedded within the culture of the company

Risk Appetite

Supervisors (and rating agencies) and Standards for Good Corporate Governance say that good risk management requires a statement of risk tolerance/appetite.

Many insurance companies struggle with developing good statements of risk tolerance/appetite !

Why is this ?

Risk Appetite

Risk Appetite Statement

- The (written) articulation of the aggregate level of risk and the types of risk that an institution is willing to accept (or to avoid) – to achieve objectives
- Includes
  - Qualitative aspects
  - Quantitative measures
    - Expressed relative to earnings, capital, risk measures, liquidity and other measures as appropriate
  - Should address hard to measure to quantify such as reputation and market conduct – and – ethical aspects and asset laundering

Risk Appetite

Risk Appetite Framework - RAF

- Sets the institution’s risk profile and is fundamental to the development of business strategy
- Will determine the risks undertaken
- Alignment with
  - business plan
  - Capital planning
  - Compensation schemes
- Common framework and comparable measures across the institution
- Expression of the boundaries within which the institution is expected to operate
- Communicated throughout the institution

Risk Appetite

Risk Appetite Framework

- Communication across the institution
- Top down and bottom up directions
- Fundamental in establishing consistent risk **culture**
- Evaluate risk opportunities and defense against excessive risk taking
- Natural impact on board discussions, risk management and internal audit
- Adaptable to market conditions

Risk Appetite

Risk Appetite Statement

- Linked to strategy
- Address material risks – normal and stressed conditions
- Establish boundaries
- Quantitative measures
  - Loss or negative outcomes
  - Earnings, capital, liquidity, growth, volatility
- Qualitative measures
- Set out rationale for accepting risks, avoiding risks
- Aggregate risk appetite needs to be allocated to business units

Risk Appetite

What are some qualitative risk appetite statements

- Capital ratio > x
- Maintain dividend payout ratio
- Growth in profits
- Stock price growth
- Maintain market share
- Avoid adverse publicity regarding consumer complaints
- Comply with all regulatory requirements
- Make progress in new distribution channels

Risk Appetite

What are some qualitative risk statements

- Maintain service levels to customers
- Retain existing corporate accounts
- Expand product portfolio
- Ensure ongoing liquidity
- Avoid catastrophic risk accumulation
- Increase diversification in broker channel
- Maintain (regulatory) composite risk rating
- Improve board skill sets

Risk Appetite

What are some quantitative risk statements

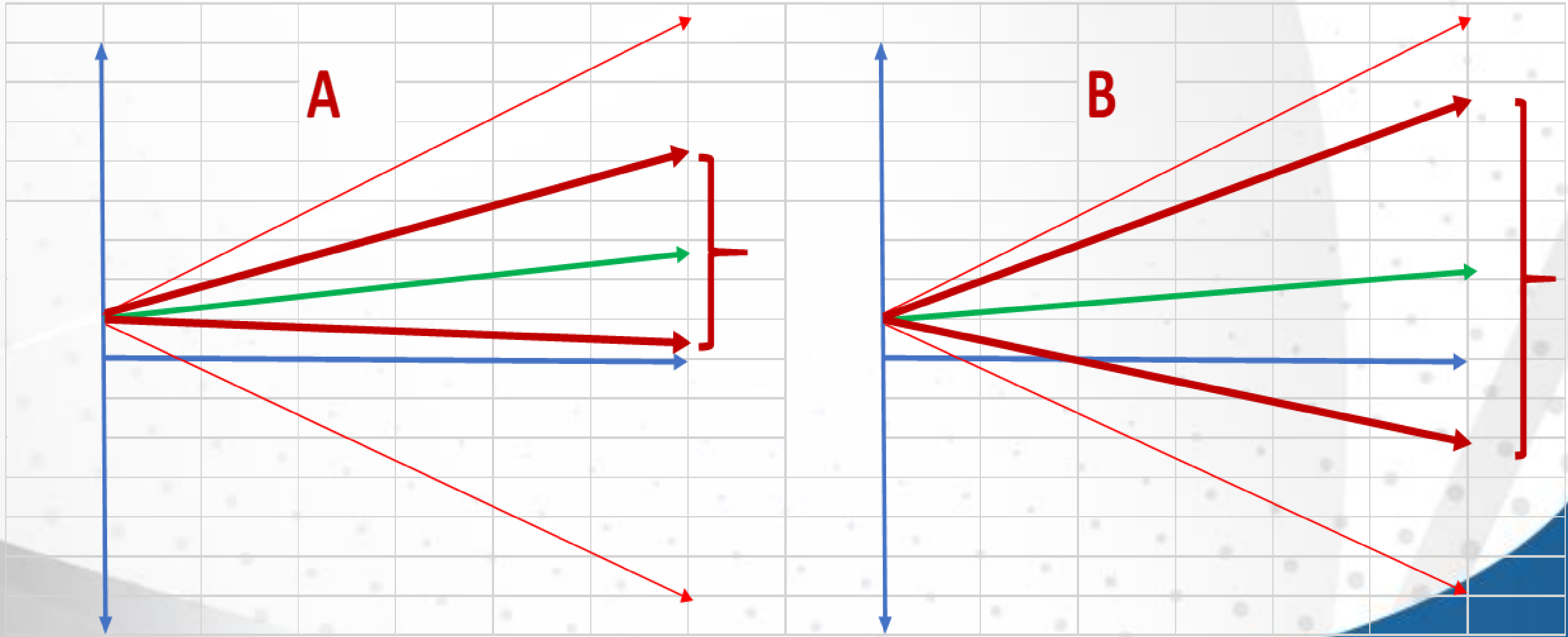
- Capital ratio > x%
- Investment portfolio – min. 65% gov't guaranteed
- Leverage measure < y%
- Investment policy – commercial grade, min credit quality BB-d
- Combined loss ratio < x%
- Interest rate sensitivity < 1.5 yrs duration, as a % of capital
- Consumer customer credit scoring > y%
- Foreign exchange mismatch < 20% assets/liabilities, as a % of capital

Risk Appetite

What are some quantitative risk statements

- Corporate credit rating > x%
- Policy limits – commercial property < \$3 mn, special acceptance for >\$ mn
- Loan concentration
  - Industry A > 25%,< 40%
  - Industry B > 15%, < 25%
- Commercial mortgages < 8%
- Decline all motor policies – male < 25 years

Different Risk Appetites – are you concerned?



Enterprise Risk Management

Corporate governance

↳ Enterprise risk management

- *The supervisor requires the insurer to have a risk management policy which outlines how all relevant and material categories of risk are managed, both in the insurer's business strategy and its day-to-day operations.*

Enterprise Risk Management

Corporate governance

↳ Enterprise risk management

- Main aspects include:
  - How all relevant and material categories of risks are managed, in the business strategy & the daily operations
  - Processes and methods used for monitoring risk
  - The relationship between tolerance limits, regulatory capital requirements and economic capital
  - Should include explicit policies on: risk retention, risk management strategies, diversification, ALM, investment management and underwriting
  - Should address relationship between pricing, product development & investment management

Control Functions (Oversight)

Corporate governance

↳ Oversight

- The insurer to establish, and operate with, an effective system of internal controls
  - Risks, prudent conduct of business, reliability of information systems, compliance (internal and external)
- Requirement to have effective control functions
  - Generally – risk management, compliance, actuarial, internal audit

Control Functions (Oversight)

Key criteria for control functions:

- Independence from operational units
- Authority to conduct it business
- Reporting to CEO/Board
- Ability to escalate issues
- Access to all information
- **Collectively – are able to determine if the company's operations, results and risks are consistent with the Risk Appetite Framework**

Control Functions (Oversight)

Subsidiaries:

- An insurer may be a subsidiary of a foreign entity
  - It may adopt certain risk or control policies and practices of the parent company that govern strategy, risk oversight and controls
  - The Board must be satisfied that these policies and practices are appropriate for the insurer’s business plans, strategy and risk appetite and comply with Costa Rican regulatory requirements

Own Risk and Solvency Assessment

Corporate governance

↳ Own risk and solvency assessment

- To assess whether risk management and solvency is adequate – and will remain so in the future
- To encompass all reasonable and foreseeable risks
- To determine the financial resources it needs
- ORSA is more specifically tied to a company's internal risk management processes and decision making processes

Own Risk and Solvency Assessment

- Why do we have to do this? We are already accountable for SUGESE's capital adequacy requirements?
- A regulatory capital tool – is risk sensitive – but it is a relatively broad brush – it cannot capture the nuances or the specificities of an individual company's operations

Own Risk and Solvency Assessment

The regulatory capital test – yes it does provide a cushion – that is partially what regulatory capital is – but it is based on the balance sheet – **remember – risk based supervision is to be forward looking as is risk management** - ORSA will align capital requirements with future operations (and risks)

Own Risk and Solvency Assessment

- Regulatory capital – balance sheet focus – but what about Risk Management – a critical focus of RBS – factors applied to a balance sheet have no possibility to be sensitive to the quality (or lack of quality) of risk management/oversight at individual companies.

- ORSA is forward looking – as is the capital assessment of SUGESE RBS

Own Risk and Solvency Assessment

An important caveat: **if risk is viewed as being unacceptably high – or if risk management is considered to be weak – capital can be viewed as a temporary or short term mitigant while inherent risk is brought with acceptable bounds or risk management is strengthened – but 'extra capital' cannot be accepted as a substitute for effective remediation**