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The Geneva Association - General Secretariat - 53, route de Malagnou - CH-1208 Geneva
Tel.: +41-22-707 66 00 - Fax: +41-22-736 75 36 - secretariat@genevaassociation.org - www.genevaassociation.org

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Layout & Distribution: Valéria Kozakova

The Role of the CRO in a Challenging Environment

Robert E. Lewis

The CRO's Challenge from the Market

- Markets reward companies generating returns on strategic risks
- Markets discount companies with perceived or real risks to non-strategic risks
- Goals
 - Maximize capital employed to strategic risks
 - Minimize capital required to cover non-strategic risks

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Internal Drivers for Better Risk Management Processes

- **Boards of directors** – more attuned to firm-wide risks
- **Management** – common language to drive results
- **Risk-adjusted returns** – driving resource allocation
- **Risk appetite** – risk required to meet business objectives
- **Stress on capital** – natural disasters, terrorism, blackouts, pandemics
- **Efficient capital allocation and optimization**

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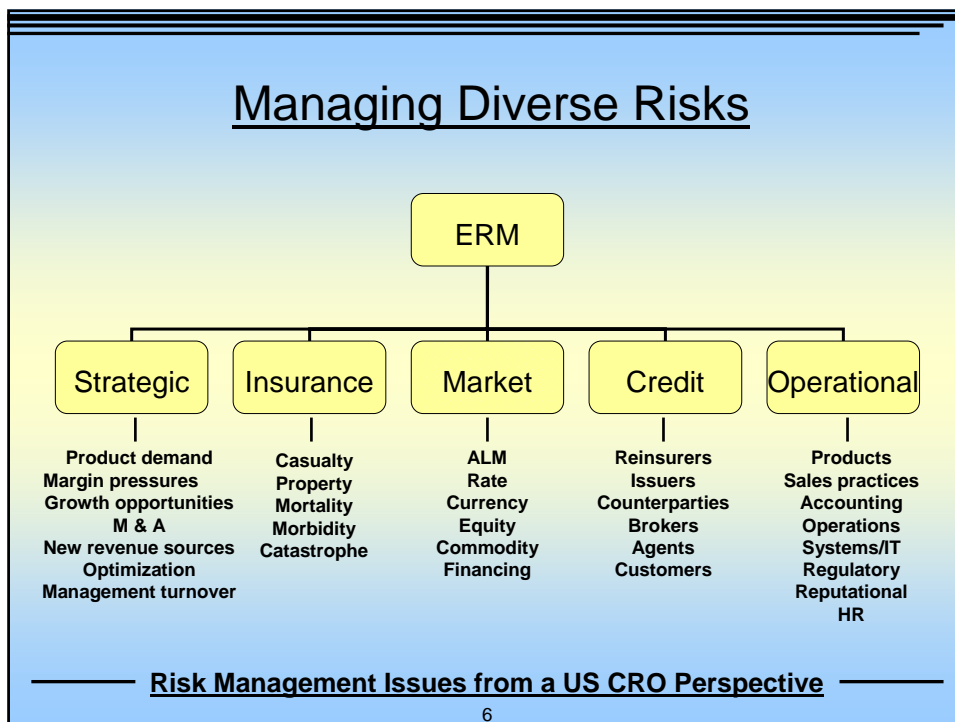
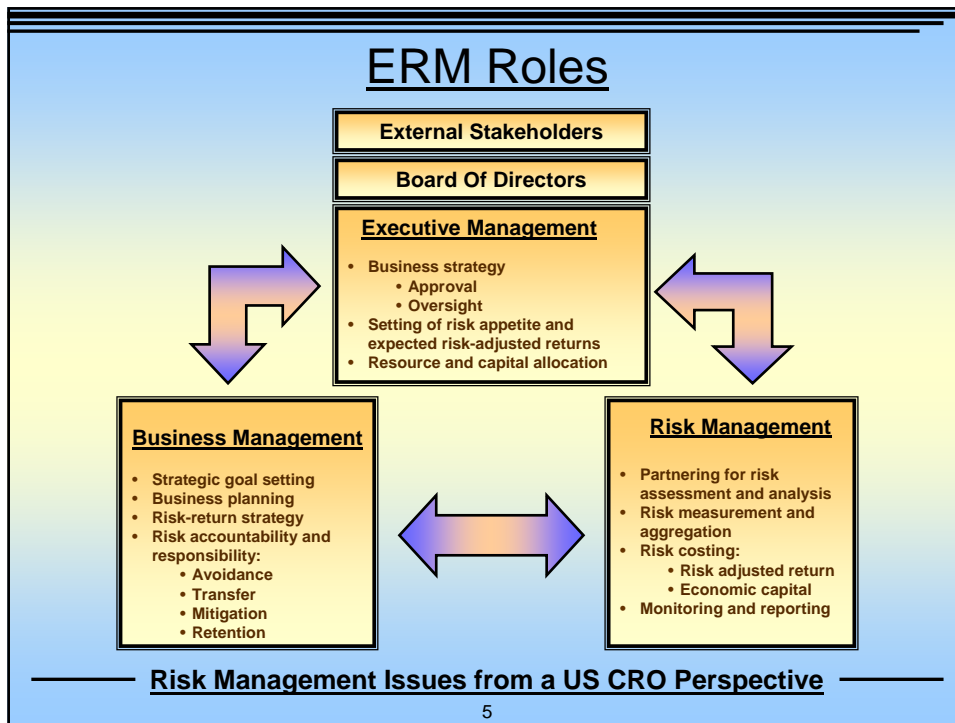
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Goals of Risk Management and the CRO

- ERM is a management function, not merely a control and compliance function.
- Risks must be identified, assessed, quantified, mitigated and managed at all appropriate levels.
- Risks affecting shareholder value must be elevated.
- Management must instill accountability and responsibility at all levels of the firm.

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Economic Capital Management

Scenario-based simulation or other advanced methods will generally be used to calculate Required Economic Capital.

1. Identify all the relevant risks
2. Develop loss distribution functions
3. Combine distributions
4. Measure and allocate required capital

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Economic Capital Management

Focus starts on capital adequacy, then leading to capital allocation, performance measurement and compensation.

Capital Adequacy	Capital Allocation	Performance Evaluation
<ul style="list-style-type: none"> How much do we need (Required Economic Capital)? How much do we have (Available Economic Capital)? 	<ul style="list-style-type: none"> How much capital will we allocate amongst the Business Units? What benefit do we derive from diversification? 	<ul style="list-style-type: none"> How will we evaluate and optimize BU's performance? How will we evaluate business managers performance? How will we influence compensation policy?

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The Challenging Environment

- Increasingly unclear boundaries among financial services
- Globalization
- Environmental change
- US legal environment
- US regulatory environment
- Legislation through regulation
- Rating agencies
- Lack of convergence among accounting regimes
- Lack of convergence among regulatory regimes
- Economics vs. accounting
- Complexity in priority setting

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External Drivers Affecting Risk Management Processes

- **Investors/Creditors/Policyholders** – value creation juxtaposed to solvency
- **Environment** – what new risks we should be pricing now?
- **NYSE** – new listing standards
- **HC regulator** – requiring ERM at consolidated level
- **Insurance company regulators** - requiring legal entity specific regulation
- **International regulators** – requiring both HC and legal entity regulation
- **SEC** – requesting for enhanced risk disclosure in MD&A
- **Sarbanes-Oxley Act of 2002** – financial reporting
- **Rating agencies** – requiring ERM frameworks

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Enterprise Risk Management

What is the nexus for effective risk management?

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Enterprise Risk Management

Risk Management Convergence

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- ## Satisfying Diverse Requirements
- Risk Management must work to maximize and optimize returns while meeting stakeholder expectations***
- **Investors** seek maximum return, but punish for unexpected volatility
 - **Boards of directors** oversee to provide assurance
 - **Management** requires economic return for risks
 - **Insurance regulators** and the rating agencies are primarily internal control and solvency oriented
 - **SEC** and **NYSE** exchange want better disclosure, internal control of financial reporting and board oversight
 - **International regulators** seek better accounting and solvency measures
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