

# **ERM Benchmark Survey Report**

December 2011

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## Executive summary

During 2011, PACICC began work on a project to promote the use of effective enterprise risk management (ERM) practices by its member companies. As the P&C insurance industry's financial guarantee fund in Canada, PACICC is strongly committed to improving the depth and quality of risk management as a means of mitigating solvency risk.

PACICC decided to begin the project by surveying its member companies to benchmark the extent to which they are using sound ERM practices. Our survey was developed with input from an industry advisory committee of risk management experts – the members of which are listed in Appendix I of this report. The survey was conducted during the summer of 2011. (The survey questions are reproduced in Appendix II). PACICC has now had an opportunity to analyze the survey findings and is issuing this report to inform members and other industry stakeholders.

The response to the survey was robust – and the findings encouraging. More than 60 member companies responded, representing over 80 percent of the premiums covered by PACICC. A clear majority of members reported having either a documented ERM plan or an established risk management framework. The good news here is that P&C insurers are clearly adopting ERM practices – they do not need to be “sold” on its importance. That said, the task of integrating effective ERM practices and day-to-day insurance operations remains a work in progress for many companies. In addition, PACICC's survey revealed that insurance companies are using a wide variety of sources as guidance for ERM. Not surprisingly, there is considerable variation in how ERM is being implemented by insurers.

In concluding the survey, PACICC took the opportunity to ask respondents if they would welcome assistance in implementing ERM in their organizations. Many answered yes, and specified areas that are challenging, including defining risk appetites and tolerances, measuring economic capital, operational risk, and risk governance. The desire of insurance companies for practical advice and assistance with ERM implementation came through clearly. Accordingly, starting in 2012 and continuing over the next several years, PACICC will sponsor a series of ERM seminars for members. Documented success stories and case studies will be a prominent feature. At an appropriate future date, PACICC plans to survey member companies again to gauge progress on implementing ERM.

Risk management is fundamental to the business of insurance. The best-performing insurance companies have always distinguished themselves on the basis of superior risk management capabilities. Increasingly, the performance of insurers will be shaped by how well they manage risks in an integrated manner across the entire enterprise.

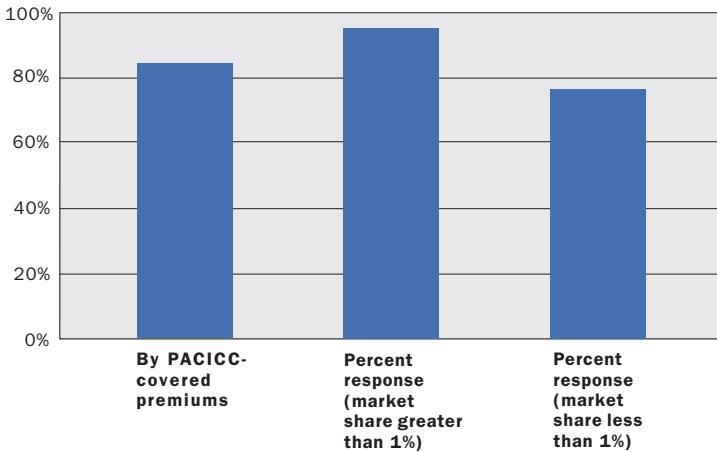
Paul Kovacs  
*President and C.E.O.*  
PACICC

## 1. ERM is being adopted by Canada's insurers

More than 90 percent of Canada's largest P&C insurers, and almost 75 percent of the smaller insurers that responded to PACICC's survey, indicated they have a documented ERM plan or an established risk management framework.

The 2011 PACICC ERM Benchmark survey included responses from 64 member insurers accounting for 82 percent of the P&C insurance premiums written by member insurers. PACICC

### Member response to PACICC's ERM survey



Source: PACICC

has 22 members with market shares exceeding one percent of the Canadian market, and 21 of these larger insurers responded to the survey. PACICC has 80 members with market shares of less than one percent, including 25 in runoff, and 43 of these 55 smaller, active member insurers responded.

Nineteen of the 21 larger responding member companies, and 32 of the 43 smaller responding members have a

documented ERM plan or an established risk management framework. Clearly ERM is now widely in use across the Canadian P&C insurance industry.

Several smaller insurance companies indicated that they had chosen not to adopt ERM, and provided reasons why they believe that developing an ERM policy was not appropriate for their organization. (See comments on page 7.)

## **2. A wide variety of sources are currently used as guidance**

Canada's insurers identified a wide variety of sources of information that they are using for guidance in formulating their risk management policies. A dozen sources were identified by members in the 2011 PACICC Benchmark Survey and included:

- COSO Framework
- UKFSA guidelines
- OSFI guidelines (including E-18)
- CIA/CAS guidelines
- Solvency II
- Basel II/Basel III
- AS/NZS 4360: 2004
- ISO 31000
- AMF guidelines
- Guidelines provided by reinsurance brokers
- Best practices guidelines supplied by consulting firms.

Despite the range of sources used by Canada's insurers the essential elements of their approach to ERM are likely similar. Nonetheless, it appears important for insurance regulators to understand and assess the differences in the approaches – and to ensure that future ERM guidance they may consider issuing for insurance companies incorporates the most essential elements (and elements in common) from the varied sources now being used.

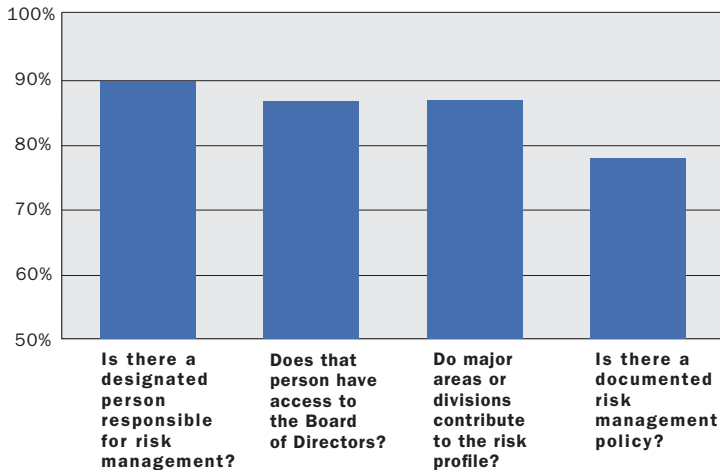
### 3. There appears to be considerable variation in implementation

Approximately 90 percent of the responding companies identified an individual with primary responsibility for risk management. Titles varied considerably and include Chief Risk Officer, CFO, VP Risk Management, Risk Manager, CEO, Chief Agent, Compliance Director, VP Internal Audit, and Chief Actuary. The survey did not probe to determine the companies that have identified an individual with responsibility exclusively for enterprise risk management, compared to those where

risk management is one element of their responsibilities.

#### P&C insurance company risk management practices

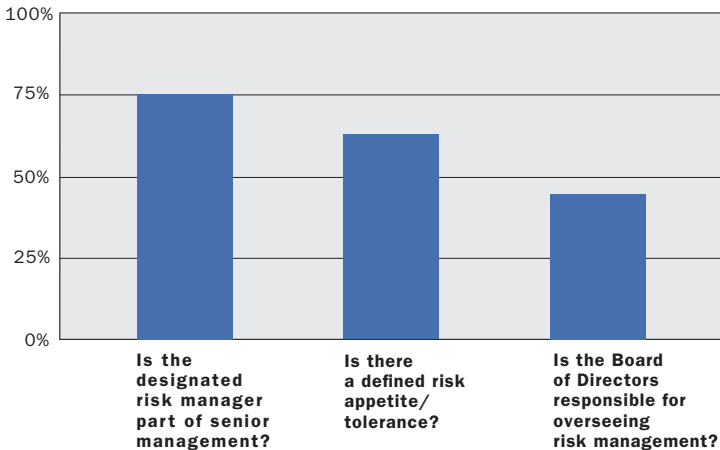
Percent of institutions responding



In addition, more than 80 percent of respondents indicated that the Board of Directors and/or senior management regularly review and reassess the risk profile of the company. (Most often this is an annual review, but several companies do this quarterly or semi-annually.) Unfortunately, this implies that almost 20 percent of respondents do not presently have their risk profile regularly reviewed by the Board or senior management.

#### P&C insurance company risk management practices (continued)

Percent of institutions responding



Source: PACICC

The survey did not probe to determine whether the Board of Directors “owns” responsibility for risk management, or if this is viewed as the responsibility of senior management and perhaps reviewed by the Board. More than 60 percent of respondents have a risk policy statement that clarifies their risk appetite or risk tolerance – a policy that likely was developed by senior management

and perhaps approved by the Board of Directors. The person identified as having prime responsibility for risk management reports to the Board or to the Risk Management Committee of the Board for 33 percent of responding member insurers, and to the CEO or CFO for 60 percent. (In this context, it is worth noting that approximately half of OSFI-supervised P&C insurers have Boards of Directors in Canada.)

#### **4. Differences observed for Federally or provincially supervised insurers**

While PACICC's ERM survey did not explicitly focus on Federal versus provincially supervised companies, we were able to observe some noteworthy differences based on the responses. In four areas, insurers whose solvency was under Federal supervision rather than provincial appeared to have more robust risk management practices. The four areas were:

- Is your company's risk appetite or risk tolerance expressed as (and aligned with) specific risk limits that individual managers are allowed to take? (66 percent of Federally supervised respondents answered "yes" compared with 54 percent of provincially supervised respondents)
- Is there an "owner" or person primarily responsible for managing each risk? (84 percent of Federally supervised respondents answered "yes" compared with 63 percent of provincially supervised respondents)
- Has your company's ERM policy or risk-management framework been reviewed by internal or external (independent) auditors or experts? (65 percent of Federally supervised respondents answered "yes" compared with 50 percent of provincially supervised respondents)
- How frequently does the Board of Directors or senior management review and reassess your company's risk profile? (23 percent of Federally supervised respondents did this quarterly compared with 13 percent of provincially supervised respondents).

## 5. ERM remains a “work in progress”

Almost 80 percent of our member insurers would like PACICC to support industry seminars focusing on effective ERM practices. A number of topics (27 in total) were suggested as opportunities for further education. The topics identified are likely areas where P&C insurance industry ERM practices continue to evolve:

- Risk accumulation (also, aggregate risks)
- Exposure mapping
- Building an ERM framework, including practical experience (possible “building block” ERM sessions – what does and doesn’t work)
- Measuring risk (also, determining the cost of risk)
- Managing reputational or non-financial risks
- Emerging risks
- Operational risks (including metrics)
- Economic capital
- Can you have an effective ERM framework without economic capital?
- Who should be in charge of ERM?
- Impact of new accounting changes on capital levels
- Capital optimization
- Defining, developing and updating risk appetite
- Effectively integrating risk appetite
- Risk reporting (for example, dashboards) and key risk indicators
- Strategic risk management
- Monitoring risks
- Stress testing
- IT risks (for example, social media, clouds, data security)
- Risk management in the future
- ERM in a small P&C company context (practical approaches to establishing ERM Policy)
- Case studies
- Share best practices
- How to minimize or eliminate regulatory risk
- Board participation in ERM
- How to utilize ERM as driver of strategy for business.



## 6. Other noteworthy comments

The survey offered respondents an opportunity to provide additional comments about ERM. A number of respondents did so. We have listed below the comments that seemed to PACICC most noteworthy.

- “Specific risks are managed individually; ERM is on the radar, to be undertaken in the future”
- “Answers reflect our position we will reach over the next few months, as we are implementing our ERM framework”
- “We are in the process of developing an ERM policy for our company”
- “ERM policy is in progress and when complete will capture our risk appetite and tolerance, with specific limits, and will be approved by the Board of Directors. The Risk Committee, chaired by the CRO, will have primary responsibility for oversight of the ERM policy”
- “Qualifications/standards/experience to be a risk manager”?
- “Optimal placement of ERM within an insurance company”?
- “Correlation of ERM with other governance processes, for example: internal control, internal audit, and compliance”
- “Whereas we have addressed our key areas of risk in the OSFI Supervisory Framework context and have established limits in all lines, a reinsurance policy, monitoring systems (for example, exception reporting, PML analyses performed regularly), we do not now have a documented ERM policy nor a centralized, organized catalog of risks. I hope the findings of this survey are published”
- “Our company’s ERM practice (our policy, appetite, tolerances, limits and overall framework) are currently in a state of development. We are working towards creating a holistic approach to ERM that makes sense in terms of our size, risk profile, and stakeholder expectations. The responses we have provided are in respect to our current, or near-future, situation. Within the next 6 to 12 months we would anticipate a significant modification to our current ERM procedures”
- “As a 100%-owned subsidiary, we are one piece of a larger ERM (policy) across the organization. We underwrite a single product line, which simplifies monitoring and aggregation of risk”
- “Basic ERM policy has just been defined; on our ‘to do’ list of areas to work on in the near future”

- “We are in the process of developing a reinsurance risk management policy to address some of our risks. A more robust ERM policy has yet to be formally developed”
- “Our current risk tolerance is based on maintaining an internal capital target, and the risk of potential opportunities are assessed to determine the potential risk to maintaining our internal capital target. All managers are aware of our target level”... “We currently do not quantify the impact and likelihood of each risk, however, each risk is discussed with all department heads regarding the impact and likelihood and prioritized using a heat map”
- “We are a small mutual P&C company writing (\$x) million annual premium with a surplus in excess of (\$3x) million. We manage our risk with sound underwriting practices, an extensive loss prevention program, and sound investment policy”
- “We are a small mutual company with hands-on management and centralized operations in a small geographic area. We know where our risks are but have not documented them in an ERM profile”

## **Appendix I – Members of PACICC’s ERM Advisory Committee**

- Randy Besse, SGI Canada
- Ron Bilyk, Zurich Insurance
- Brandon Blant, Intact Insurance
- John Cairns, Chubb Insurance
- Greg Dunn, Aviva Canada
- Lyne Giroux, Dejardins Insurance
- Michelle Hengen, Cooperators General Insurance
- Ray Kearns, State Farm Insurance

PACICC’s ERM project, including the work of the ERM Advisory Committee, is being managed by Jim Harries, the Corporation’s Vice President of Operations.

Mr. Harries is also the author of this report.

## Appendix II – PACICC member survey on ERM practices

### Introduction

We ask that you complete PACICC's member survey on Enterprise Risk Management (ERM) practices for P&C companies. The survey highlights some of the practical elements that underpin a robust ERM program. The survey seeks to gain knowledge on where the P&C insurance industry is doing a good job in managing enterprise risks, and where progress may be needed.

### Why is PACICC sending this survey to its member companies?

- ERM is widely considered to be a best practice for P&C insurance companies (and all financial institutions) to use in managing their risks.
- Canada's insurance regulators – OSFI, in particular – strongly recommend that P&C insurance companies enhance their processes for managing risks on an enterprise basis.
- The survey provides an opportunity to assess how the P&C insurance industry is doing in adopting effective ERM practices.
- PACICC has adopted its own Board-approved ERM Plan and encourages its member companies to do so.

### Who should complete the survey?

- We recommend that the survey be completed by the member of management who is most knowledgeable about how your company is assessing and managing risks across the entire organization.
- Ideally, that person would be recognized as the Chief Risk Officer for your company – but the survey respondent could also be the CEO or the Chief Financial Officer.

### How will the survey results be reported?

- When the results have been gathered and analyzed, PACICC plans to issue a written report summarizing key findings and recommendations.
- The report will be circulated to PACICC members and to other stakeholders such as insurance supervisors.
- Please note: individual company responses to the survey will be kept confidential by PACICC; **results will only be reported in aggregate, not at the individual company level.**

## Key risk-management terms used in this survey

### **Enterprise Risk Management:**

A process – implemented by an entity’s Board of Directors, management and other personnel, applied in strategy setting and across the enterprise – designed to identify potential events that may affect the entity, to manage risk to be within its risk appetite, and to provide reasonable assurance regarding the achievement of entity objectives.

### **Risk appetite:**

The degree of risk – broadly measured, in quantitative terms – that an insurance company is willing to accept in pursuing its business goals and values. Risk appetite requires an insurer to consider its total risk-taking philosophy, including the expectations of its shareholders.

### **Risk tolerance:**

Requires an insurance company to consider, in quantitative terms, exactly how much of its capital it is willing to lose, as well as its tolerance of volatility in earnings and other measures of performance and value.

### **Risk limits:**

Requires an insurance company to consider in detail how much risk that individual managers should be allowed to take.

*Sources: Committee of Sponsoring Organizations (COSO II); and Society of Actuaries*

## Survey questions

1. Does your company have a documented Enterprise Risk Management (ERM) Policy, and/or do you operate within a “risk-management framework” with established procedures? Yes  No

Note: If you answer “no” to Question 1, please skip to Question 5 and complete the remainder of the survey as applicable.

2. What guidelines or documents has your company used to arrive at its ERM Policy or risk-management framework?
- 

3. Does your company’s Board of Directors have primary responsibility for overseeing the ERM Policy? Yes  Partly  No

4. Does your company’s Chief Agent and/or senior management have primary responsibility for overseeing the ERM Policy? Yes  Partly  No

5. Is there an individual who has primary responsibility for managing risk in your company? Yes  No

6. If “yes,” what is that individual’s job title? \_\_\_\_\_

To whom does that individual report? \_\_\_\_\_

Does this individual have access to the Board of Directors? Yes  No

Is he or she part of the company’s executive management team? Yes  No

7. Do you have a risk policy statement that clarifies your company’s risk appetite or risk tolerance? Yes  No

8. Is your company’s risk appetite or risk tolerance expressed as (and aligned with) specific risk limits that individual managers are allowed to take? Yes  No

9. Do you maintain a risk profile (register or inventory) of all of the material risks identified by your company? Yes  No

10. Do all of the major areas or divisions of your company contribute to the development of, or have input to, the risk profile? Yes  No

**11.** Does your company's risk profile contain or address the following:

- Information relating to each risk, including causes and triggers, existing management practices or controls? Yes  No
- An "owner(s)" or person(s) primarily responsible for managing each risk? Yes  No
- A consistent process and rating system used to assess and measure the impact and likelihood of each risk? Yes  No
- Prioritization of individual risks based on the ratings assigned? Yes  No
- Action plans to mitigate priority risks? Yes  No
- Monitoring processes? Yes  No  If "yes," please briefly describe your company's risk-monitoring process: \_\_\_\_\_

**12.** Which of the following key risk areas are explicitly addressed in your company's risk profile?

- Underwriting risk – Risks assumed through the insurance contracts written by your company. Yes  No
- Credit risk – Risks related to changes in the credit quality of counterparties or intermediaries your company is exposed to – including reinsurance. Yes  No
- Market risk – Risks that arise from volatility in financial markets, including changes in interest rates, bond and stock prices. Yes  No
- Liquidity risk – Risks related to possible cash flow shortfalls, including cash calls following major loss events, credit rating downgrades, problems accessing financial markets, and so forth. Yes  No
- Operational risk – Risks arising from potential deficiencies with respect to people, processes or systems in areas such as claims management or information technology (risks that are outside of the four areas noted above). Yes  No
- Strategic risk – The risk of loss arising from poor strategic business decisions. Yes  No
- Reputation risk – Risks that could undermine policyholder, regulatory and/or public trust in your company's products, services or brand. Yes  No

**13.** Does your company form an aggregate measure of its enterprise risks (for example, as related to economic capital), or would it be more accurate to say that you manage risks individually? Or both? (Please check one box) Aggregate risks  Individual risks  Both

- 14.** Does your ERM Policy take account of capital requirements, including projections of your company's future financial position and ability to meet regulatory capital requirements?  
Yes  No
- 15.** Has your company's ERM Policy or risk-management framework been reviewed by internal or external (independent) auditors or experts? Yes  No
- 16.** Does the Board of Directors and/or senior management regularly review and reassess your company's risk profile? Yes  No  If "yes," with what frequency? \_\_\_\_\_
- 17.** Would you be interested in attending P&C insurance industry seminars on effective ERM practices (possibly sponsored by PACICC)? Yes  No  If "yes," what topics would interest you?  
\_\_\_\_\_  
\_\_\_\_\_

Please add any other comments you may have about ERM and/or this survey:

Survey completed by (name and position): \_\_\_\_\_

Company: \_\_\_\_\_ Date: \_\_\_\_\_



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