THE GUARANTEE™

# MANAGING IN A CHANGING WORLD OF RISK

## PACICC Risk Officers Forum
## December 15, 2015

Alister Campbell
CEO, The Guarantee Company of North America

# THOUGHT PROCESS

1. The financial services industry did not distinguish itself in the Financial Crisis of 2008.

2. While the P&C industry held up better than any other and proved itself not to be “systemic”, regulators can’t afford to overlook any sector in their duty to ensure no repeat of the Crisis.

3. The dramatic surge in new regulatory expectations and requirements is not a surprise.

4. Canada has always distinguished itself with common sense financial services regulatory oversight. But OSFI is also seeking to continue to define new best practices ahead of the global curve…

5. New requirements are proving onerous and the wave of new OSFI guidelines is challenging all Risk Managers and the CEOs and Boards they report to.

# BACK TO FIRST PRINCIPLES…

## I STARTED (AS ALWAYS) WITH ADAM SMITH…

To take an example, therefore, the trade of the pin-maker; a workman not educated to this business, nor acquainted with the use of the machinery employed in it, could scarce, perhaps, with his utmost industry, make one pin in a day, and certainly could not make twenty. But in the way in which this business is now carried on, not only the whole work is a peculiar trade, but it is divided into a number of branches, of which the greater part are likewise peculiar trades. One man draws out the wire, another straights it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving, the head; to make the head requires two or three distinct operations; to put it on is a peculiar business, to whiten the pins is another; it is even a trade by itself to put them into the paper; and the important business of making a pin is, in this manner, divided into about eighteen distinct operations, which, in some factories, are all performed by distinct hands, though in others the same man will sometimes perform two or three of them. I have seen a small manufactory of this kind where ten men only were employed, and where some of them consequently performed two or three distinct operations. But though they were very poor, and therefore but indifferently accommodated with the necessary machinery, they could, when they exerted themselves, make among them about twelve pounds of pins in a day. There are in a pound upwards of four thousand pins of a middling size. Those ten persons, therefore, could make among them  upwards of forty-eight thousand pins in a day. Each person, therefore, making a tenth part of forty-eight thousand pins, might be considered as making four thousand eight hundred pins in a day. But if they had all wrought separately and independently, and without any of them having been educated to this peculiar business, they certainly could not each of them have made twenty, perhaps not one pin in a day; that is, certainly, not the two hundred and fortieth, perhaps not the four thousand eight hundredth part of what they are at present capable of performing, in consequence of a proper division and combination of their different operations....The division of labor, so far as it can be introduced, occasions, in every art, a proportionable increase of the productive powers of labor.

What type of risk is riskiest?

How do we monitor and measure insurance/operational risk?

Is this different by size of business?

Should the scope and scale of risk oversight vary in proportion?

# New Guidelines have proliferated

OSFI has been busy!

1. Background Checks
2. Reinsurance Sound Practices
3. Earthquake Exposure Sound Practices
4. Stress Testing
5. Corporate Governance Guideline
6. Internal Capital Target
7. Own Risk Solvency Assessment
8. Minimum Capital Test Guideline
9. Regulatory Compliance Management
10. Derivatives Practices
11. Operational Risk Management

# HOW WE HAVE REACTED…
# …THE FOUR STAGES

**A**

OH NO! NOT MORE!

**B**

WELL…WE HAVE NO CHOICE…

**C**

HEY…THIS IS KINDA INTERESTING…

**D**

HMMM!…GLAD WE DID THAT… LEARNED SOMETHING!

# EXAMPLES OF VALUE EXTRACTED

- Risk Appetite Statement
- Own Risk Solvency Assessment
- Comprehensive Risk Report

# BRIEF PROMOTIONAL INTERLUDE

- The Guarantee Company of North America
- 143 Year-old and Canadian-owned Market Leader in:
  - Contract & Commercial Surety
  - Fidelity/Crime
  - Public Entity
  - High Net Worth Homeowner

GUARANTEE GOLD®

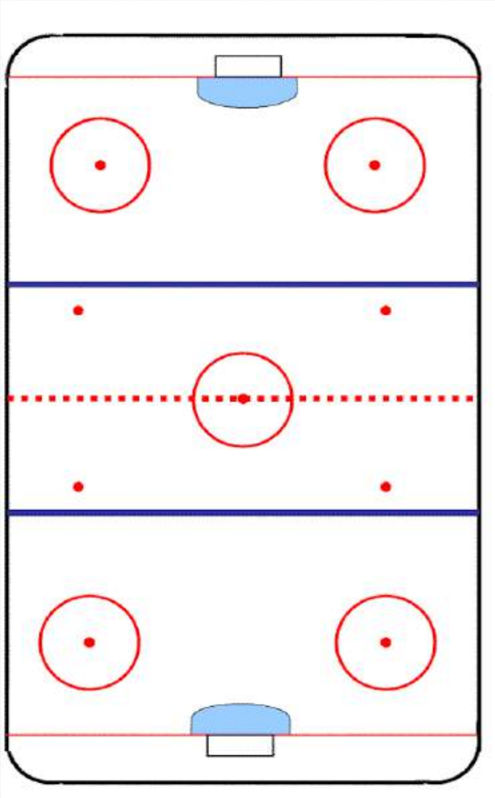
# JUST HOW BIG IS “OPERATIONAL RISK”?

- Transaction processing
- Fraud (Internal/External)
- Technology
- Business Continuity
- People
- Outsourcing
- Product
- Physical security
- Money Laundering
- Terrorist financing
- Privacy
- Information Security
- Legal/Contract management
- Modelling
- Financial Reporting
- Process change

# OPERATIONAL RISK vs. INSURANCE RISK

- Insurance risk clearly by far the largest component in our ORSA.
- There will of course be value extracted from the process of reviewing policies/procedures and developing best practices to reduce operational risk.
- **We need to manage the possible confusion around the types of "operational" risk which actually manifest themselves through adverse loss development and/or higher loss ratios – isn't this part of what we call insurance risk today?**
- **And how do we model for these "operational" risks with limited (or no) company or even industry data?**

# WHAT ABOUT THIS “MULTIPLE LINES OF DEFENCE” ISSUE?



- Role of the first line of defence is clear…we can think of the underwriter as the goalie…
- The role of the third-line of defence is also clear…we can think of Internal Audit as the referee/linesman…
- But today, our goalie and our defencemen (underwriting referrals) work collaboratively…they are on the same team after all.
- **How does a company our size implement another separate line of defence on our rink? Should we have to? Where does it fit?**
- **And how many other functions in our organization really require another “line of defence” on top of what we already have?**

# I ASK MYSELF…

- How many of the PACICC “Why Companies Fail” series illustrate insolvencies caused by breakdowns in Operational Risk?
- Are there in fact any cases to document? In Canada?  Where else?
- Maybe PACICC could do some work on this to help better inform our industry and our regulators?
- Perhaps this work could also help better inform us as we work to determine much capital we need to allocate in our ORSA for Operational Risk.

# ONWARDS AND UPWARDS!

- Risk management is always about continuous improvement
- We cannot expect the regulatory burden around risk to trend downwards any time soon.
- Best to extract the value we can from the process.
- We need to always remember that insurance risk remains by far the biggest issue for any P&C insurer!