

Banking & Investments Perspective



Premise for burden



- Theoretical context
 - Investors can manage risk through hedging/diversification so little incremental benefit
- Value not as noticeable
 - Only when something goes wrong
- Often seen as “negative” thinking
- Financial costs of risk mitigation
 - Capital and Liquidity Costs

The Case for the Benefit

- Theoretical context
 - Prevention of financial distress
- More “distress vectors”
 - Cyber Security
 - Other operational risks
 - Reputational Risk
 - AML
 - Traditional financial risks (credit / liquidity)
- Risk premia may compensate for volatility but not distress
- Businesses susceptible to “lowest risk denominator”
- Make business more sure-footed
 - Known risk appetite
 - Crisis Preparation
- Risk culture promotes understanding of risk and clear definition of risk appetite



The Case for the Benefit

At the end of the day risk management is about taking risks in the most optimal fashion within clearly defined risk appetite levels.

- Supported by strong risk governance – top of the house
- Internal controls and processes



Banking and Investments



- Regulatory evolution → moving towards Basel III
- Many international and therefore influenced by international regulation
- Risk management still value added without regulator
 - Independent risk management often helps to shape regulation and ensure practicality
 - Prior to implementation supervision focuses on the robustness of risk management practices
- Premise for Burdens
 - Costs associated with liquidity and capital requirements
 - Cost of resources and systems
 - “Stop sign” connotation
- The Case for the Benefits
 - Regulatory and Board confidence
 - Sure-footed when risks can be efficiently and prospectively quantified and not blindly considered at every move.
 - Additional perspective to drive optimal resource allocation
 - Uncovers risk capacity
 - Analytical inputs relevant for business lines



Especially Important Now...

- ...while times are good
 - General tendency to discount possibility of distress
 - Look out for signs of a bubble
 - Yield starvation
 - Flood of participants
 - Look beyond today's environment to tomorrow's risks
 - Won't be fashionable
 - Risk Culture is Built in the good times
 - Culture usually the largest factor in failure
 - Effective Risk management most important factor for long term viability



Insurance Perspective



Risk management – burden or benefit?

Burden

- Lack of data/and mitigation options
 - No deep and liquid markets for market data
 - Stocks
 - Bonds
 - match liability cash flows longer durations
 - Index/inflation linked bonds
 - Swaps and swaptions
 - Mortgage securitisation
 - Limited data for non market/insurance data
 - Mortality:
 - No prescribed mortality tables or shocks
 - Longevity swaps
 - Expenses/lapse:
 - no prescribed regulatory shocks

Risk management – burden or benefit?

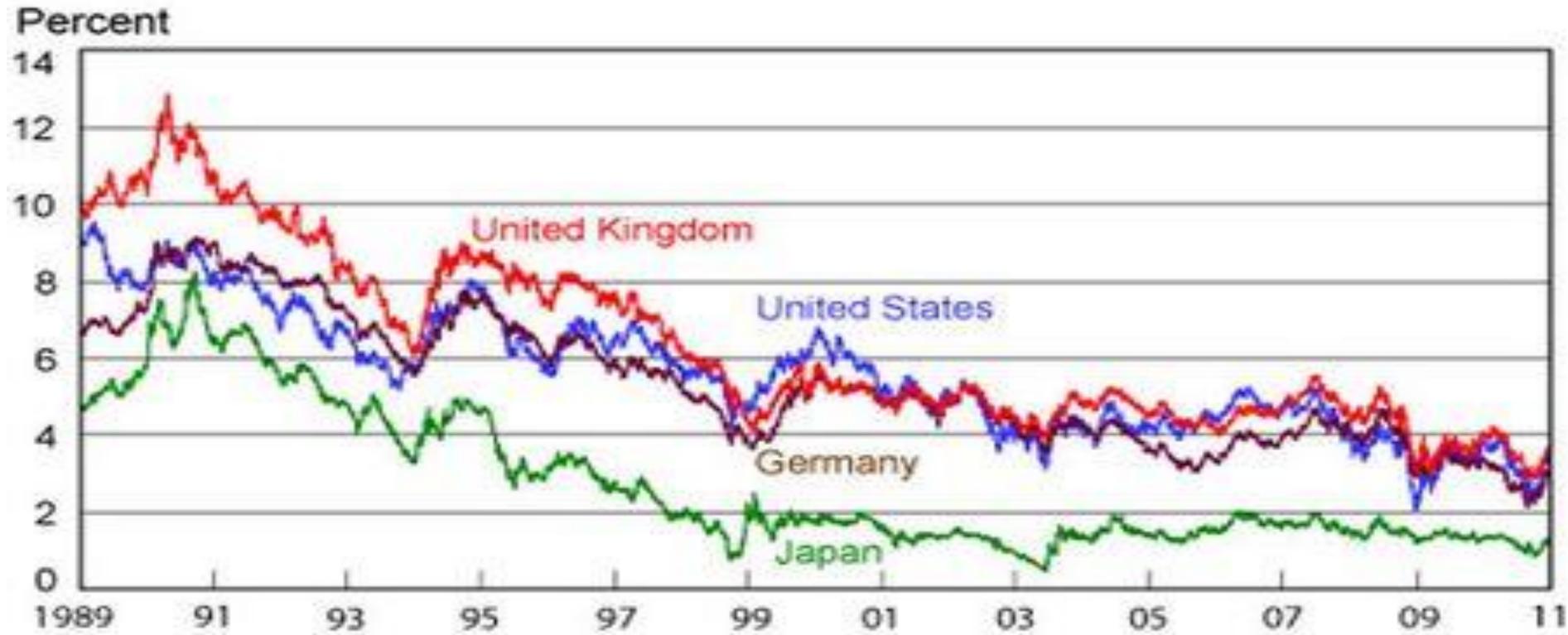
Burden

- Not adding value to the business
 - Operational risk
 - Limited options for mitigating risks
- Duplicating work of other functions (operations, audit) or creating additional workload without clear benefits
- Mega models that can't be understood by non-experts

Risk management – burden or benefit?

Historical background – Equitable Life

Ten-Year Government Bond Yields



Source: Bloomberg L.P.

Risk management – burden or benefit?

Historical background – Equitable Life

- Equitable Life and McDonnell report
 - Single/best estimate scenario insufficient to fully understand potential risks or events (black swans)
 - Value at risk
 - Scenario analyses
- Lack of understanding of interaction between risks
 - Longevity and interest rates (annuities)
 - Lapse and stocks (unit linked)

Risk management – burden or benefit?

Current risk management Caribbean

- More advanced for banking regulation than insurance
- More qualitative than quantitative
 - Edwards Deming “Without data you're just a person with an opinion”
 - -> opportunities for and added value to be created by actuaries!

Risk management – burden or benefit?

Benefit

Use scenario analysis to prepare mitigating actions in advance



Risk management – burden or benefit?

Benefit

- Develop risk management “fit for purpose” for the Caribbean region
 - Instead of mega models use scenario and sensitivity testing
 - Perform nation and industry wide studies on mortality, and other insurance related risks to improve understanding and impact
 - Start sharing anonymous data on operational risks
 - Focus on adding value to the business instead of limiting business opportunities
- No regulatory requirements
 - Ensure risk management adds value to the business
 - Change product mix to offset and mitigate risks
 - Base decisions on risk weighted return instead of standard return



Next Steps...





So we're agreed that it's a benefit...

How do we sell the benefit/lessen the “burden”

- UNDERSTAND THE BUSINESS AND ITS NEEDS
 - but remain independent
- Act like a business partner
- Better communication of our outputs
- Provide the effective challenge that the 3rd line of defense can't
 - Distinguish self from the 3rd line function
- Evolve to where the business wants risk's perspective
 - Not to check a box but to add valuable perspective.
 - Use data intensive nature to add value