



# Scenario Planning + the Future of ERM

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- Prediction is very difficult,
- especially if it's about the future.
- Niels Bohr, Sam Goldwin, Yogi Berra

**No battle plan survives first contact with the enemy.**

- Helmuth von Moltke

**Measure twice, Cut once.**

- Carpenter's rule

**The reason the American Army does so well in war is because war is chaos and the American Army practices chaos on a daily basis.**

- Unknown German Officer in WWII

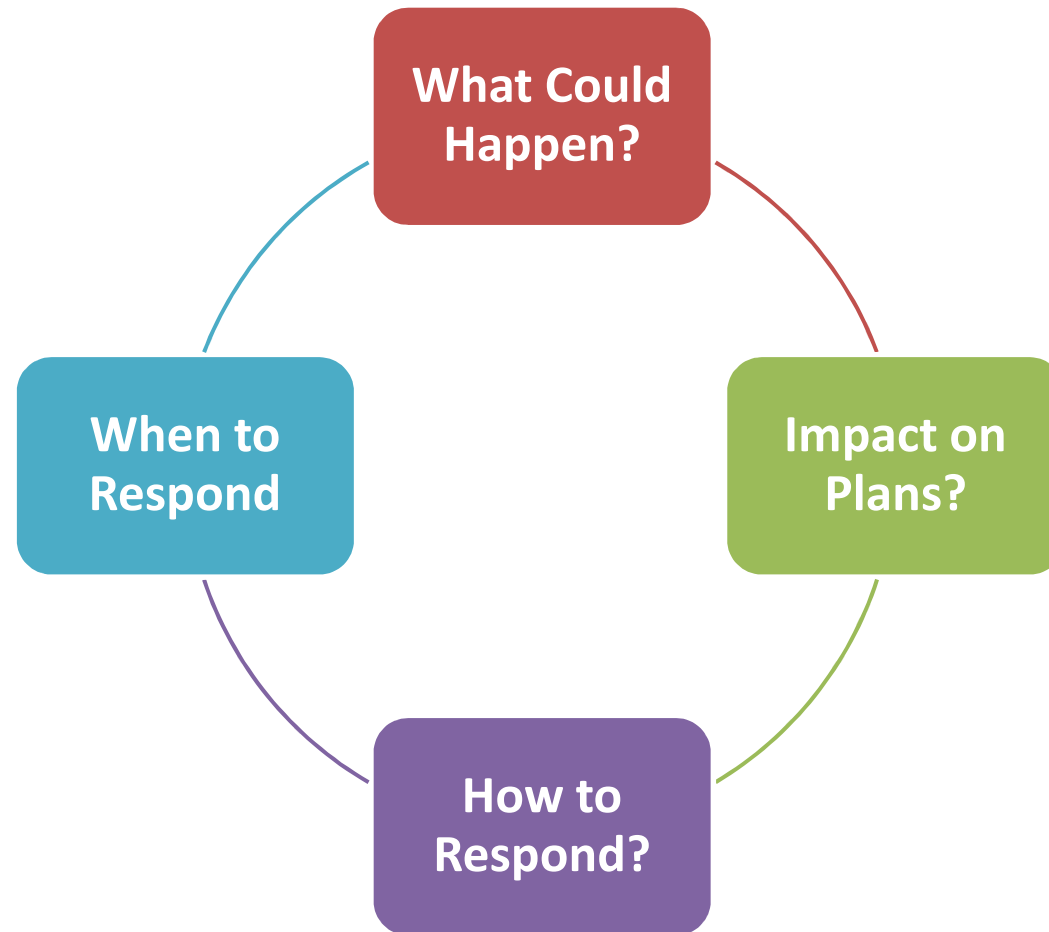
# Scenario Planning

- The goal of scenario planning is to create several future stories and then to explore your company strategies in each scenario. (Hiemestra)
- Will learn that there are:
  - Core Strategies that are used in almost every scenario
  - Alternate strategies that will only be used in specific scenarios if they develop
    - Determine checkpoints for considering shifting to Alternate Strategies

# Hard Truths about ERM

- Shell Oil was one of the original users of the idea of Scenario Planning
  - With their first scenario planning exercise in the early 1970's they identified the possibility of the Gas crisis that soon hit the world
    - And they were able to respond much more quickly than their peers
- In 2008, Shell identified 3 Hard Truths about their business:
  1. Global Energy Demand was surging
  2. Supply will struggle to keep up with demand
  3. Climate change is a pressing reality
- Hard Truths about ERM
  1. ERM done right is expensive and demands lots of executive and board time
  2. It is difficult to give credit for the lack of something (crises)
  3. Insurers with strong ERM programs will still be hurt by large but rare events

# Working with Scenarios



# What Could Happen?

- Appoint a team to develop Scenarios.



- Pick a timeframe



# Team will then . . .



# Driving Forces





# What is the Impact on Plans?

For each Scenario...

- Look at each driver that is different from your base scenario
  - What are the consequences of that difference?
  - How significant is this to your plans?
  - Is there any offset or multiplier from the combinations of changes in drivers?

# How can we respond?

Stay the  
course

Boldly Go

Turtle

Totally  
different  
Direction

# Key Drivers for ERM Scenarios



# Key Drivers for ERM Scenarios

	Base Scenario	Deviations
<b>Economics</b>	Moderate swings in line with 2009 – 2019 period	<ul style="list-style-type: none"> <li>Return to period like Great Moderation</li> <li>New financial crisis</li> </ul>
<b>Technology</b>	Innovations keep happening gradually.	<ul style="list-style-type: none"> <li>Major breakthrough leads to sweeping changes.</li> <li>Innovations slow as society struggles to incorporate prior.</li> </ul>
<b>Environment</b>	Gradual changes to environment. Reversion to long term trends	<ul style="list-style-type: none"> <li>Benign period which reverses trends towards larger and larger disasters</li> <li>Major catastrophes &amp;/or Liability disasters</li> </ul>

# Key Drivers for ERM Scenarios

	Base Scenario	Deviations	
<b>Social Attitudes</b>	Continued expectation that financial firms must manage own risk taking	<ul style="list-style-type: none"> <li>Reversion to Caveat Emptor attitude. Boards &amp; Management will generally do appropriate risk management.</li> </ul>	<ul style="list-style-type: none"> <li>Expectation that financial firms must be almost totally bullet proof</li> </ul>
<b>Regulation</b>	Risk related regulatory regimes frozen at current level.	<ul style="list-style-type: none"> <li>Risk related regulatory requirements diminish.</li> </ul>	<ul style="list-style-type: none"> <li>Risk related regulatory requirements Increase.</li> </ul>
<b>Shareholders</b>	Continue to evidence little notice of risk management or lack thereof.	<ul style="list-style-type: none"> <li>Actively oppose corporate expenditures to enhance risk management.</li> </ul>	<ul style="list-style-type: none"> <li>Actively encourage corporate expenditures to enhance risk management.</li> </ul>

# ERM in 2030

## Six Scenarios

Technology  
Revolution

Gradual  
Evolution

First Priority

Compliance  
Only

Subsumed

Fad Passes

# Gradual Evolution

- Economic capital as a universal risk/return metric for all viable insurers.
- Reduction in biased risk related decisions - gut decisions drastically reduced.
- Regulators > rating agencies > investors will generally demand that companies demonstrate ERM practices.
- Risk reports are widely understood and used across the organization.
- Boards will receive insight on risk to support decision-making from top down scenario analysis and stress testing
- Managers begin to understand approximately how much risk increases or decreases with their decisions without waiting for risk models.

# Gradual Evolution



## Impact

- Strain on Resources
- Can only do a little more each year

## Responses

- Continually look for efficiencies
- And things to eliminate

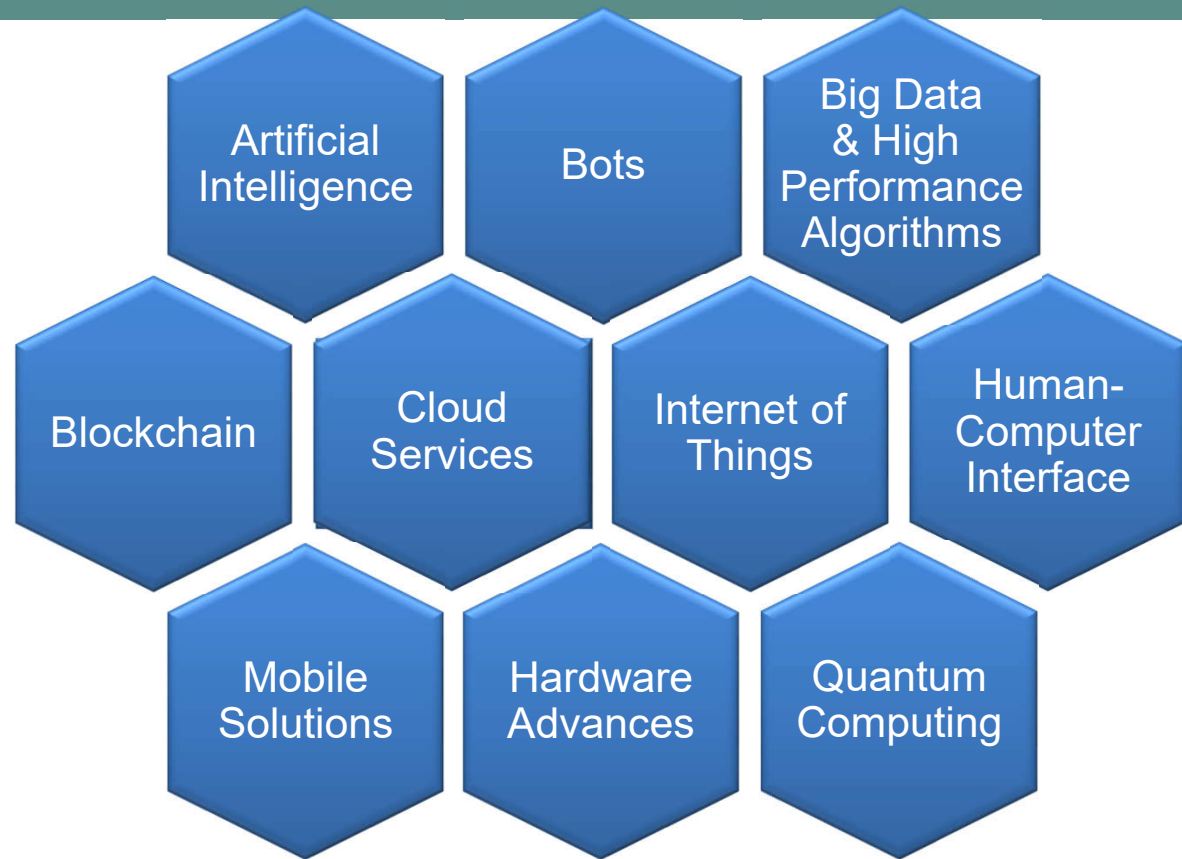
## Triggers

- New Risks
- Areas of faster growth



# Technology Revolution

**How might we enhance and transform insurance through focused application of emerging technologies?**



*Technologies build on one another and are typically used in combination to deliver solutions*

# Technology Revolution



## Impact

- Advanced analytics creates competitive advantage
- Rapid changes impact IT resources and requires specialists

## Responses

- ERM implementation becomes key investment
- Advances in management reporting

## Triggers

- Leading edge companies pull further away from pack
- Reinsurers start to require more data and make different decisions on offerings

# Compliance Only

- A global recession leads to cost cutting that stifles the innovation that was getting starting back in 2019.
- Companies shift to a compliance only approach to ERM. Only doing what regulators say that they have to do.
- Rating Agencies back down from emphasis on ERM (e.g. S&P in 2018)

# Compliance Only



## Impact

- ORSA & ERM requirements become sole driver of ERM
- ERM rarely is of any importance to management
- Resources for ERM shrink to bare minimum

## Responses

- Develop low tech risk metrics applying 80-20 rule
- Drastically simplify ORSA work

## Triggers

- Regulatory requirements grow more and more specific
- Budget cuts force CRO to choose between going out of compliance and other ERM priorities

# ERM is Subsumed into General Management of Insurers

- Risk Management is fundamental to insurer's basic approach to the business.
  - Focus on prevention, mitigation, and advisor role
- Becomes fully embedded in business operations.
- ERM function withers away as a separate function.
- Likely caused by technology advances and customer requirements.

# Subsumed



## Impact

- All managers are expected to do Risk Management for their area
- Little attention to managing aggregate risk
- Risk reporting moves to within financial reporting area

## Responses

- Develop risk management training for all managers
- Promote a risk role within planning function

## Triggers

- More and more risk work transferred to operating managers
- Special ERM requirements reduced (i.e. ORSA becomes a one page form to fill in)

# ERM Fad Passes

- ERM goes the way of a long list of temporary management fads. Such as:
  - Six Sigma
  - Business Process Engineering
  - Matrix Management
  - Management by Consensus
  - Core Competency
  - Management by Objectives
  - Search for Excellence
  - Delayering
  - Empowerment
  - Management by Wandering Around
  - Theory Z

# ERM Fad Passes



## Impact

- ERM Budget gets trimmed. Requests for staff are refused. People start skipping meetings.
- ERM Department suddenly closed completely

## Responses

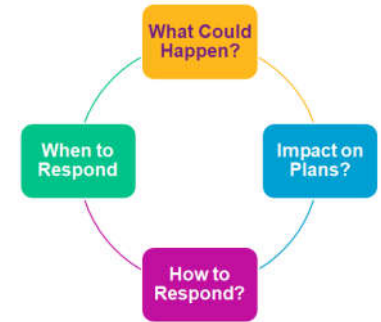
- Make sure that ERM has achievable goals
- Keep ERM focused on Strategic Priorities
- Be careful for demands for work outside ERM

## Triggers

- Extended moderate risk environment
- Star BU looks fantastic on traditional measures but not on risk adjusted basis



# ERM Fad Passes



## Impact

- ERM budget gets trimmed. Requests for staff are refused. People start to skip meetings
- ERM department is suddenly closed completely.

## Responses

- Make sure that ERM has achievable goals
- Keep ERM focused on Strategic Priorities
- Be careful of demands for work from business units

## Triggers

- External: Extended moderate environment
- Internal: BU that seems successful on traditional measures but is not on risk adjusted view

# First Priority

- Another financial crisis or maximum claims year triggers a shift to very conservative strategies for insurers.
  - With a redoubled emphasis on ERM.
  - CRO becomes the second most powerful position in the company
  - Management demands risk analysis every time a decision was made, every day, not once a quarter or once a year. They wanted to see risk impact on their bottom line, cash flows, schedules and project NPV, not just a capital adequacy tool.
- How to succeed in that Scenario?

# ERM becomes first priority



## Impact

- Everything slows down – becomes very cautious
- Anything “NEW” becomes suspect

## Responses

- Major increase in RM staff – more and more analysis required
- Pull back of first line participation in ERM – unwilling to take responsibility for risk decisions

## Triggers

- A Black Swan type event – belief that we should have known better – all of the information was available
- High demand for insurance – but only from the most highly secure insurers

# Conclusions

## Scenario Planning

- Consider doing scenarios for top 3 – 5 risks
- Work with risk owners
- Bring into planning discussions

## ERM in 2030

- Did we capture all of the likely futures for ERM?
- Is Gradual Evolution your base scenario?
- Are you ready for the sorts of changes we mention there?
- Which other scenario do you think is most likely?

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