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## ENTERPRISE RISK MANAGEMENT

By Michael J. Moody, MBA, ARM

# ACTUARIAL INSIGHT INTO ERM

*SOA defines guiding principles to help organizations better identify and manage risk*

**A**mong the earliest proponents of the ERM concept are actuarial professionals. In fact, actuaries have been actively promoting ERM through one of their professional associations, the Society of Actuaries (SOA), since the concept was introduced. Recently SOA developed a professional ERM designation, the Chartered Enterprise Risk Analyst (CERA), the first new credential that SOA has introduced in more than 60 years. The CERA has drawn significant interest from risk professionals worldwide.

Recently SOA announced its "Five Guiding Principles of ERM." SOA points out the importance of these principles by stating that without them, "businesses may find themselves at a perilous crossroads in defining and managing risks and,

instead, may over-mitigate risks, underestimate risk exposures or altogether miss opportunities to capitalize on risks."

And as S. Michael McLaughlin, FSA, CERA, FIA, MAAA, member of the SOA board of governors and global leader, A&IS, for Deloitte Consulting LLP, notes, "ERM is closely related to the actuarial sciences, so it is only natural that we have gotten involved with it." As a result, he says, "Leading actuaries, in partnership with the SOA, urge businesses to commit to the five principles to evaluate their ongoing ERM investment."

### SOA's Guiding Principles

The following is a summary of the five principles:

**A qualified leader.** Without proper guidance, training and leadership from a skilled risk professional, attempting to navigate risks can be a futile exercise. Thus one of the most important guiding principles is finding a qualified leader, and SOA believes the new CERA professional credential will distinguish those skilled risk professionals. "Every consulting firm in the world can now advise you on ERM," McLaughlin says. But, he points out, "While it is good that we have that level of risk awareness, the SOA thinks it will be the credentialed individual who will be able to take the leadership role here."

McLaughlin says that holders of the CERA designation will "actually be able to provide an actuarial approach to ERM." This approach will allow for a comparison of several different events or courses of action, by quantifying the various alternatives. As McLaughlin explains, "The actuarial approach moves beyond just a qualitative analysis towards more of a quantitative analysis." This approach, he says, "can really help management make better decisions. This is where I believe our credentialed experts can be the most help."

**Clear communication.** An ERM program must be able to provide some type of actionable information. Thus this guiding principle states that the "ERM process that does not lead to the translation of highly complex and technical issues cannot arrive at actionable information to make smarter, more confident decisions." SOA thinks it is necessary to "sell" the need for risk management; however, it is equally important that businesses set the correct "tone at the top," by establishing a corporate culture that fosters a willingness to listen to what they need to do.

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—S. Michael McLaughlin, FSA, CERA, FIA, MAAA  
SOA Board of Governors Member



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**A combination of qualitative and quantitative information.** Although ERM has been around for several years and is no longer a new concept, SOA members note that many companies are not practicing this technique. Part of the problem, they believe, is that organizations typically focus only on the qualitative side of the house.

McLaughlin indicates that, "An organization is highly likely to have a successful ERM program if they look at both the qualitative and the quantitative aspects of risks. This is really the only way to get the total picture. You must have both parts."

**Broader focus.** McLaughlin also notes that businesses need to broaden their focus "beyond the attitude that risk is just something to avoid. Certainly," he says, "unknown risks are bad, but risks that can be quantified can represent opportunity." From his standpoint, "If you can measure a risk, it can be turned into an opportunity." Unfortunately, McLaughlin observes, too many business owners still fear risk and are having difficulty seeing the upside of risk.

**An attitude adjustment.** This guiding principle states that delivering on the promise of ERM depends on being able to see risks differently. A key goal is to refocus attention on the positive aspects of risks, according to McLaughlin. The principle further states that understanding risk exposures and defining the "risk appetite" should maximize every opportunity. McLaughlin points out that "ERM is way beyond a portion of a compliance exercise."

He goes on to note that too many organizations have lumped ERM into the compliance effort, and he says, "Having ERM in this area puts a border around risks that usually prohibits seeing the upside of risks." For this reason, he says, it is important that ERM be viewed separately from any compliance-related activities.

### Summing up

From the start, SOA has been able to see the long-term value of ERM. Initially, in some cases, SOA members became the corporate risk officers (CROs) of some insurance companies and other financial institutions. SOA's ongoing commitment to ERM is evident in the creation of the CERA designation, its first new designation in more than 60 years.

However, one of the obvious shortcomings of SOA's involvement in ERM is a lack of SOA members generally, and more specifically CERAs. And while SOA is seeing significant

worldwide interest in the new CERA program, growth will be slow. However, SOA does recognize this issue, and McLaughlin says the association is working to "staff up" for increased interest in the CERA designation. SOA, then, is suggesting that the best use of its limited resources may be via consulting assignments that incorporate an actuarial view of risks.

At this point in the evolution of ERM, the actuarial profession, through its professional association (SOA), has offered significant support for the ERM concept. Issuance of the guiding principles

offers additional assistance to those who are establishing their own ERM programs. It's clear that as the ERM concept matures, SOA and its members will have significant input into the final ERM models that will shape ERM in the future. ■

### The author

*Michael J. Moody, MBA, ARM, is the managing director of Strategic Risk Financing, Inc. (SuRF), an independent consulting firm that has been established to advance the practice of enterprise risk management.*

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