# Increasing urgency and evidence of opportunity

## A survey of chief risk officers in the insurance industry

Ernst & Young
Quality In Everything We Do

# Executive summary

Ernst & Young's annual survey of Chief Risk Officers (CROs) in insurance clarified the impact of some of the "megatrends" driving fundamental changes in the industry today, as well as the new ways carriers view, manage and account for risk across their operations. Many of these new risk management drivers — the fallout from the economic crisis of 2007-08, new regulatory requirements and difficult global macroeconomic conditions — are well known. However, the survey results underscore how these forces are changing the role of the CRO. Four overarching themes emerged from the 2012 survey:

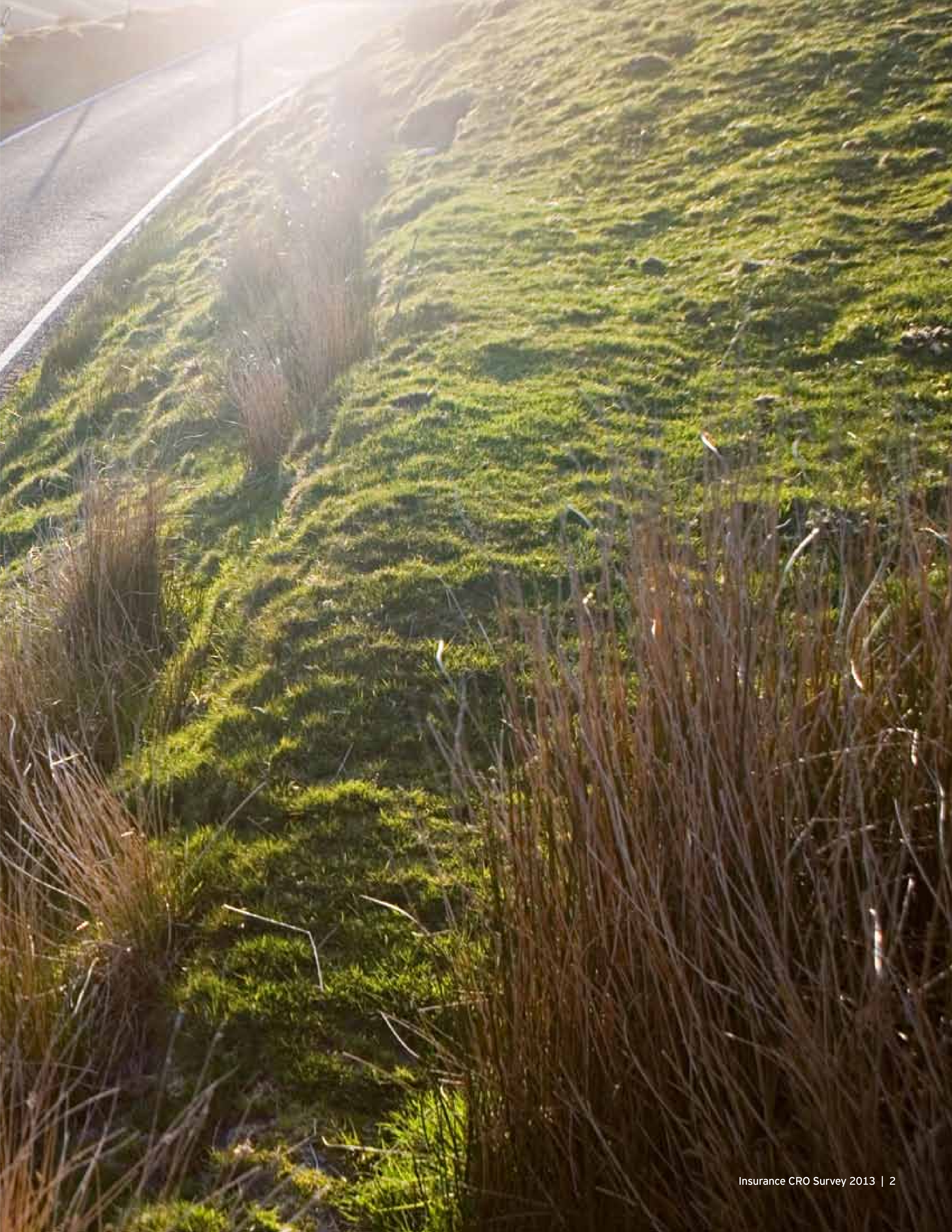
**The rising prominence of CROs:** The difficult economic environment and ongoing regulatory shifts have provided CROs a unique opportunity to demonstrate their value. They are engaging more directly with business-unit leaders and working more broadly across the enterprise than ever before. For example, a few insurance CROs are working with operational functions (including new product development and Information Technology (IT)) in which they were rarely involved in the past. Others are taking on responsibility for new risk areas (such as IT risk, reputational risk and emerging risk) that are typically the domain of banking CROs. There is every reason to believe these trends will continue in future survey results. It is clear that deep and broad risk management capabilities are needed across the insurance enterprise, and CROs have the experience, knowledge and toolsets to deliver them. See page 4.

**CROs and the risk "journey":** While virtually all insurers are more aware of the broad range of risks they face, there are many differences in terms of the maturity and efficacy of efforts to address today's risk profiles. Individual insurers find themselves in different phases of their risk management "journeys." The role, authority and visibility of the CRO, as well as the risk management priorities, differ considerably based on company size, geographic footprint, product portfolio, strategic initiatives and organizational structure. See page 5.

**Regulatory challenges and compliance priorities:** One reason for the different rates of evolution is the disparate impact of new regulations on various types of institutions. Some larger enterprises are focused on Solvency II (SII), as well as the impact of increased Federal Reserve (the Fed) supervision of insurers as a result of Dodd Frank. Other carriers are placing more emphasis on meeting the National Association of Insurance Commissioners' (NAIC) new Own Risk and Solvency Assessment (ORSA) requirements. See page 5.

**The risk quantification imperative:** Quantification is becoming increasingly important and more companies are devoting added resources to economic capital, capital optimization and the measurement of market, credit and operational risks. The business drivers for quantification include the need to better understand product profitability, identify and evaluate growth opportunities, and project future revenue in uncertain and volatile interest rate and economic environments. As a result, insurers are improving the sophistication of their risk quantification processes and toolsets. See page 7.

*The bottom line is that insurers have entered a new era of risk, with increased regulatory requirements and clear business justifications for embedding well-thought-out risk management strategies across the entire enterprise. In many ways, the results of this year's survey highlight the ways in which the higher profiles of CROs are both a cause and effect of this fundamental shift.*



## About Ernst & Young's CRO Survey

In the fall of 2012, Ernst & Young insurance risk analysts conducted interviews with CROs and senior risk executives at 19 North American and Bermudian insurance companies. Collectively, the companies have significant business operations in all major sectors of the insurance industry, including property and casualty, life and commercial lines of business. See the appendix for a list of participating companies and a complete list of survey questions. Tabulated responses for each question are contained in the sections that follow.

# Section 1: Major themes and analysis

## Theme 1: The rising prominence of CROs

### Key data:

- **50%** of risk departments/offices have increased in size over the last year.
- **50%** predict more direct involvement with their respective boards in three to five years.
- **45%** of CROs report to the Chief Financial Officers (CFOs), with an additional **25%** reporting directly to the Chief Executive Officer (CEO). A heightened urgency regarding risk management and the role of the CRO is shared across multiple carriers. There is general consensus that the role of the CRO should become more active and visible. Similarly, there is widespread, high-level agreement on how CROs should be involved with board-level oversight and decision making. However, there is no road map for effecting that transition. Because different companies are at different points in the evolution of their risk management approach **(see Theme 2)**, their CROs understandably have different priorities.

Looking at the broad market landscape in insurance, it makes perfect sense that CROs are taking on new roles and more activities. With lingering low interest rates, reduced profitability and depressed stock prices, insurers can no longer overlook some of the risks that were perhaps bypassed during more bullish, higher-margin eras. In some cases, insurers are facing critical questions, such as how to make money selling annuities with essentially zero appreciation or how to price products to factor in previously invisible or unknowable risks.

The high cost of extensive distribution systems is also under scrutiny, more so than ever before. Forward-looking insurers are looking into risk-adjusted compensation systems. Even marketing and branding efforts carry higher risks than previously, given that social media and consumer empowerment mean every interaction that goes awry can turn into a highly visible (and potentially costly) media event. In other words, insurers are coming to terms with the presence of risk across their operations and seeking to define the right strategies and tactics to manage it properly.

### What CROs say:

- *"Our goal is to implement a complete and embedded risk management capability that adds value instead of appeasing regulators."*
- *"Our biggest win has been executive engagement and active CEO participation in risk committee, which resulted in positive feedback from the regulator on our ERM program."*

CEOs are engaging CROs to help them address the issues across the full range of functions, product lines and operations. More than any other executive, CROs have the tools, analytical abilities and enterprise-wide perspective to shed light not just on individual risks, but on the entire complex and interdependent risk mosaic faced by insurers today. The combination of tough economic conditions and increasing regulatory requirements means that effective risk management — in a myriad of applications — and CROs are essential to bottom-line business success.

All of these factors explain why many CRO survey respondents speak of their "direct engagement with the business." Some are paying more attention to operational risk and the underwriting and pricing of risk, while others are engaging directly with field-based staff, including agents and brokers. Engaging with the business means different things for different types of insurers.

Comparisons of the forward progress of insurance CROs with that of their counterparts in banking are illustrative. For the most part, IT risk, emerging risk, new product developments and reputational risks are just now moving onto the insurance CRO agenda, while they have long been overseen by banking CROs. Clearly, insurance CROs lag behind banking CROs in terms of organizational prominence, though the gap is closing. Survey respondents report increasing involvement and visibility in higher-priority risks, including new product pricing, emerging market risk, credit risk and balance sheet risks. Future CRO Surveys are sure to show increased involvement in these areas and closer tracking in the roles of banking and insurance CROs.

While more CROs are interacting directly with their boards, the move toward a more direct reporting alignment to the CEO appears to be taking longer than predicted by respondents to previous CRO surveys. Currently, 45% of CROs report to the CFO, versus only 25% reporting directly to the CEO. However, 65% of respondents have "unfettered" access to or direct engagement with the board via enterprise risk management (ERM), audit or risk committees. While current organizational charts do not fully reflect the rising importance of the CRO, we expect future surveys to show further shifts toward CEO reporting and true organizational parity with CFOs.

## Theme 2: CROs and the risk "journey"

### Key data:

- In 2013, **25%** of respondents will be focused on economic capital, while **20%** will be focused on ORSA.
- Survey results reflect a wide variety of priorities, accomplishments and areas of responsibility.

### What CROs say:

- *"20 different CROs at 20 different insurance companies would probably have 20 different job descriptions."*
- *"Once the infrastructure is in place, the CRO role will become more strategic, analytical and involved with business planning."*

The survey results illustrate how different carriers are undertaking disparate types of journeys when it comes to risk management in general and the role of the CRO in particular. Certainly, large, multi-line global insurance enterprises are farther along their ERM journeys than their mid-sized US-based counterparts.

To a large extent, this distinction is a product of organizational complexity, the maturity and robustness of risk management practices, and the primary regulatory concerns of individual carriers. The differences reveal themselves in many ways, including:

- CRO reporting relationships
- CRO roles and responsibilities
- Ability to quantify risk
- Attitudes toward the Federal Insurance Office (FIO) and ORSA
- General priorities — from regulatory compliance to ERM

CROs are generally responsible for "all risks to the company." In practice, that broad definition includes everything from asset liability management (ALM), underwriting, credit and operational to brand reputation, IT risks and internal audit. However, among larger firms with more mature risk management programs, there is a clear shift toward more strategic tasks, such as the identification, monitoring and mediation of emerging risks. Similarly, some risk leaders have defined how CROs should interact with business units and senior management (often through risk and non-risk committee assignments).

Again, the survey results paint a vivid picture of an industry changing the way it identifies and manages all kinds of risks and of the changing role of the CRO. There is no explicit road map, recognizable benchmarks or best practices for carriers to follow as they proceed along their respective risk journeys. However, it is safe to say that CROs as leaders and early adopters are already moving away from the mechanics of reporting and regulatory compliance, and increasingly moving toward more strategic tasks with direct links to bottom-line success. In other words, CROs are likely to lead the way forward on the journey ahead.

## Theme 3: Regulatory challenges and compliance priorities

### Key data:

- **30%** of respondents expect ORSA to present the biggest implementation challenge versus **15%** for SII.
- **15%** of respondents cited regulation and accounting issues as the biggest risk challenges facing the industry.
- **75%** have special plans in place to meet ORSA requirements.

It is difficult to overestimate the impact of regulatory changes on the insurance industry as a whole. However, survey respondents understand that regulatory compliance must be achieved in a way that supports improved business performance. CROs are uniquely positioned to help insurers navigate the confluence of these sometimes conflicting imperatives.

Carriers in the US are focused on ORSA and state-level regulation. Specifically, they need to ensure they can meet new or modified reporting requirements. Therefore, they are more attuned to the role of the NAIC than they are to the possibility of an optional national charter for insurance industry oversight, though they too are considering the implications of all possibilities, especially in regards to the role of the FIO.

Certainly regulatory factors account for the different rates of evolution and varying CRO roles across carriers. Large, complex carriers with global presence are leveraging their experience with SII and taking the broadest possible view. They are studying the process of determining capital standards, reviewing their overall ERM approach and shaping regulatory strategies for what is clearly a new era of oversight. They are also carefully watching and seeking to influence the evolution of future roles and responsibilities of the states, the FIO and the Fed. Oversight by the Fed is a hot topic too, especially among carriers who own banks or thrifts and those that may be designated to be a potential Systemically Important Financial Institution (SIFI) institutions.

### What CROs say:

- *"You cannot mandate one set of standards for risk management across the industry without increasing systemic risk."*
- *"We do not understand how capital can be regulated without a common and consistent definition."*

While the current requirement for state-level reporting may be ungainly, most insurers understand the system and how to achieve compliance. CROs are speculating what role the Fed and FIO will play in rationalizing some of the reporting requirements. Similarly, some respondents see the upside in one national standard, which would also streamline global compliance.

When it comes to regulatory issues, the survey results show a clear contrast in what carriers and their CROs want to see, and the difference correlates to their size and geographic footprint. The industry is not speaking with one voice, which highlights the inherent complexity of the insurance business.

The **2012 CRO Survey** results run parallel to those from the third annual risk management survey conducted by Ernst & Young and the Institute of International Finance. This study included online surveys and telephone interviews with senior risk executives from 69 banks and 6 insurance companies across 38 countries.

**A few themes from that survey highlight those of the 2012 CRO Survey:**

- The scope, timing and potential impact of the still-evolving global and national regulatory reform is the top challenge cited by almost **75%** of survey respondents.
- "Embedding risk into the business" remains a challenge, with only **37%** of survey participants indicating they have linked it to day-to-day business decisions.
- Today, more than **80%** of CROs in financial services report directly to CEOs or jointly to CEOs and board risk committees.

## Theme 4: The risk quantification imperative

### Key data:

- **60%** of respondents' companies use economic capital as an objective measure of risk, as opposed to nearly **100%** of banks.
- **30%** of the companies cited their economic capital program as one of their major accomplishments for 2012 and another **25%** said it will be a major area of focus for 2013.

Risk quantification is becoming increasingly important, as insurers recognize just how deeply risk is embedded into their business. Developing accurate and verifiable risk assessments has become a regulatory requirement. More importantly, it is the means by which insurers must make critical business decisions and allocate finite resources. Respondents see how higher-quality risk data equates to more confident and better business decisions.

In other words, risk quantification is not simply about "playing defense" or "ticking the regulatory box," but about more clearly understanding product profitability, more methodically evaluating growth opportunities and more accurately projecting future revenue under a range of market, interest rate and economic scenarios. In this sense, risk management has become synonymous with performance management and overall business management.

### What CROs say:

- *"If you don't trust the risk numbers, then you need a larger capital buffer."*
- *"Qualitative measures are being expanded, too, with links to an actionable and clear risk-taking philosophy."*

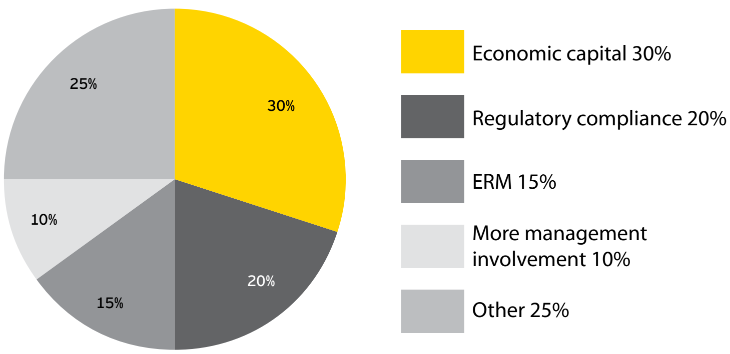
Survey respondents recognize risk quantification as an area where insurers must catch up to their counterparts in banking and other financial services sectors. Thus, carriers are devoting more resources to economic capital, capital optimization and the measurement of market, credit and operational risk. Not surprisingly, carriers are using a variety of techniques and methodologies — from ALM, stochastic simulations and stress-testing, to catastrophic modeling, long-tail estimation and risk/return analysis — as suits their product portfolios and organizational structures. Formalized programs for capital allocation and operational risk remain the exception, according to survey respondents.

The trend toward risk quantification is being driven, to an extent, by the big data and analytics revolution in the industry. Forward-looking firms now view their massive data assets as a source of valuable insights about their customers, competitors and the market. The same powerful tools and sophisticated processes that can be used to identify and target special offers to policyholders at the greatest risk of non-renewal can be used to quantify risk down to granular levels at the business-unit, product line and overall enterprise level.

Many CRO survey respondents recognize the risks presented when firms struggle to integrate and synchronize their data sets. Whether the discussion is about risk quantification, product promotions or underwriting standards, companies whose executives make decisions based on consistent, current, complete and accurate data have a distinct competitive advantage.

# Section 2: Survey questions and responses

## Q1. What was your most important accomplishment over the past year?




### What CROs say:

- *"'Professionalizing' our credit-risk framework and understanding our future needs and role. We're being approached with more credit risks and it's not clear if banks will provide all the credit we need."*
- *"SII pushed us to build our internal capital models together faster than if we would have on our own. We had extensive documentation, but now the company is stronger and more robust."*

Respondents cited approximately 30 separate areas where they made significant accomplishments, with the most popular answers listed above. In some cases, the risk effort led to clear business benefits, even if efforts were initially directed toward regulatory requirements (such as SII). The frequent listing of ERM was surprising. However, it clearly reflects the rising profile of many CROs and the broad, cross-functional and cross-business unit view they are taking toward risks. More companies are trying to improve their S&P ERM ratings and upgrading ERM programs to prepare for ORSA.

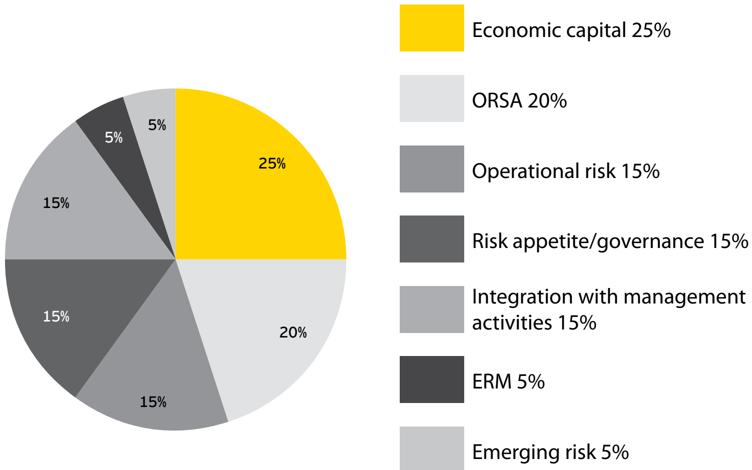
The "other" category included:

- Upgrading capabilities to measure credit risk
- Assessing interest and market risks
- Deploying risk governance
- "De-risking" the balance sheet
- Creating stress-testing capabilities
- Improved product design, especially for variable annuities

As companies struggle to de-risk their portfolios and simultaneously identify growth opportunities, they are bolstering their economic capital programs to gain new insight into risk-return balance and, thus, making better decisions about resource and capital allocation.

The contrast with last year's survey results is striking. In 2011, CROs were focused on risk reporting, risk measures, and clarifying specific roles and responsibilities across risk functions. This year's results confirm that CROs have moved forward and now understand more broadly their strategic agenda. They understand that they cannot work in isolation or assume a strictly "top-down" approach to risk management. They must engage business-unit management and collaborate on the design and implementation of risk management efforts that reach down to the business-unit level.

## Q2. In which area will you devote significantly more attention to in the next 12 months, compared with the last 12?




### What CROs say:

- *"The benefits of addressing emerging risks are very apparent, especially in terms of the pace and types of innovations. Some of the risks are very hard to measure. The key question is, 'Where do you draw the line for choosing to measure certain risks based on how likely they are?'"*
- *"Better integration of risk into business processes, including infrastructure."*
- *"Thinking through and finding a way to optimally apply a European SII framework to a United States firm, so that we can leverage the best and most valuable aspects of (SII)."*

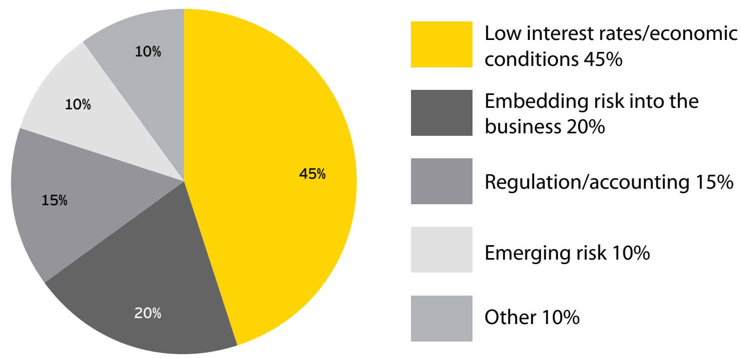
Responses to this question are consistent with last year's survey. As in 2012, CROs expect their 2013 agendas to consist of interest rate concerns and ALM, governance matters, operational risk and insurance risks. Regulatory compliance — most notably ORSA — was another item expected to remain high on the CRO "to-do" list.

The most frequently cited issue was economic capital, which will occupy a CRO's attention in 2013 and beyond. Many respondents report that they expect economic capital to be a hot-button issue for the next several years. It is important to note that respondents often cited economic capital in terms of its association or integration with management activities. CROs understand that if their risk programs, particularly as they relate to economic capital, are to be effective, they must garner the full support and active participation of the business-unit management.

Risk appetite plays a major role in both finalizing the ERM framework and, through limit and tolerance setting, operationalizing economic capital programs. It is therefore not surprising to find it among the most common responses to this question.

These findings are further evidence of the expanding role of the CROs. Because they have the right tools, proper methodologies and required skills, they are being asked to take lead roles in identifying emerging risks and establishing operational risk programs.

## Q3. What do you think are the biggest risks/challenges facing the insurance industry?




It is not surprising that there is broad consensus that interest rates and macroeconomic conditions are the top concerns for the industry. There is more variance, however, in how those concerns are felt. Respondents expressed concern about:

- Meeting profitability targets with continually low rates
- Managing variable annuity blocks
- Designing products with little or no asset appreciation

There is uncertainty around how long rates will remain at these historically low levels and about their trajectory once they finally begin to rise. There are lingering questions about future regulatory and accounting changes as well.

Interestingly, since last year's survey, embedding risk into management practices has moved above regulatory and accounting changes on the list of CROs' key concerns.

Other risk challenges cited by respondents included the changing risk profile of insurance products and new distribution channels.

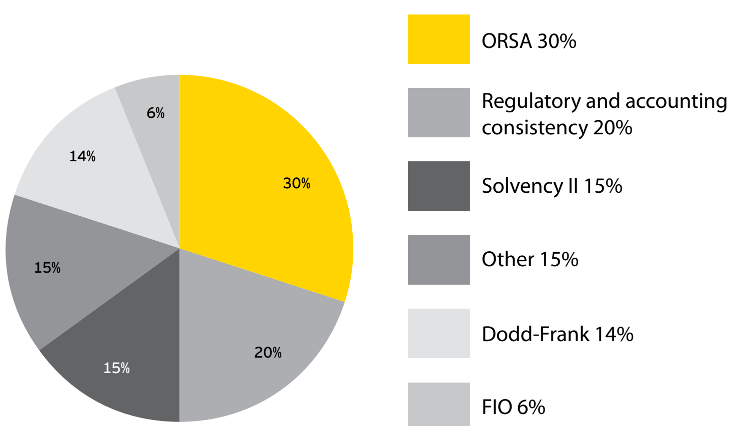
In the past, CROs were seldom asked to help address core insurance processes, but today there is an appreciation that the CRO brings perspective and methodologies that can contribute to identifying and mitigating the risk dimensions that are built into fundamental operations and reach across the rapidly changing insurance business.

Reputational risk, particularly as it applies to social media, is another new frontier for CROs. They understand that social media is not a risk per se, but can increase the velocity of "bad news" and multiply the impact of underlying risks. For example, if an operational breakdown adversely affecting customer service receives wide notice via Facebook or Twitter, the consequences can be severe and far-reaching.

### What CROs say:

- *"Prolonged low interest rates will have a very negative impact on spread-based businesses in annuity and life markets."*
- *"There will be fallout and difficult management challenges as many insurers move out of spread-based products and into traditional protection and general insurance."*
- *"Inconsistency in accounting standards and regulatory frameworks and limited coordination among regulators."*

## Q4. What specific regulations, actual or pending, will present the biggest implementation challenge?




ORSA and regulatory and accounting consistency were the primary CRO concerns in regard to regulation. Despite implementation being two years away, ORSA commands a great deal of attention. Many respondents feel that developing the report will not be a problem. CROs in organizations that have gone through SII or have robust ERM functions expect to easily meet the requirements.

However, a significant number of respondents expressed concern that NAIC's ORSA standards allow for great flexibility, but don't provide sufficient guidance. Their concern is that as the NAIC, the rating agencies and the state supervisors review many examples of ORSA reports, there will be a gradual but inexorable evolution to more comprehensive reporting formats and more prescriptive standards. Few CROs object to NAIC's ORSA, but they want more direction and guidance in developing reports and setting the standards for compliance.

Some of the larger companies expressed concern regarding the lack of consistency between US and international regulators. They expressed support for a common regulatory and accounting framework, but expressed some apprehension about their final form. The lack of a common framework makes capital management difficult.

The diversity of the responses reflects the myriad state, national and international standards that carriers must follow today. A smaller number of companies cited other regulations, including Dodd-Frank, oversight by the Fed, life insurance contracts and the Foreign Account Tax Compliance Act.

### What CROs say:

- *"It will be a real cause of concern if there is no convergence on accounting standards with various regulators."*
- *"Fed oversight is our top concern, because we don't see how one set of standards for risk management across the insurance industry can work."*

## Q5. Do you currently have specific plans in place for meeting NAIC's ORSA requirements?

More than 75% of survey respondents have specific plans for meeting NAIC's ORSA requirements, though there appeared to be a wide variation in the plans. Organizations that have been through Solvency II and those with robust capital plans have much of what they need in place; other organizations are in the process of identifying data requirements and developing initial work plans, both of which they view as significant challenges. For organizations new to ORSA, developing multi-year capital forecasts is another challenge.

Another issue on the minds of CROs is the capacity of some states to develop the necessary skills, knowledge and competencies to provide direction about and administer the ORSA regulations. In questioning whether some states will be able to provide the direction companies need as they write and submit ORSA plans, some respondents expressed their support for an optional federal insurance regulator.

### What CROs say:

- *"After implementing SII ORSA, we have retooled to meet NAIC ORSA requirements."*
- *"Development plans for ORSA are an objective this year. High-level analysis has been completed and many elements are in place, but pulling all requirements out of the organization will be a challenging exercise."*

## Q6. Are there any regulations that you would like to see the industry adopt?

An equal number of respondents expressed an optional need for a national charter or said that no more regulation is needed. In a sense, both answers reflect a desire for more clarity and less complexity in what is currently an ambiguous and constantly shifting regulatory environment. Insurance remains a highly regulated industry that is increasingly being operated, managed and regulated at both the national and global levels.

## Q7. What should be the role of the FIO?

This ambiguity among CROs' positions toward regulation can also be seen in the answers to this question. Approximately 20% believed strongly that the FIO should have a limited role or none at all. A majority of respondents believed its responsibilities should be limited to providing data and research on national risk issues and working with the states on national issues, such as taxation. They were careful to point out that it should not duplicate the functions of the state supervisors, the NAIC or the Fed oversight of savings and loan holding companies.

However, about 25% of participants believed that the FIO should pursue a more active and higher-profile role. These respondents would like to see the FIO take on some or all of the following tasks:

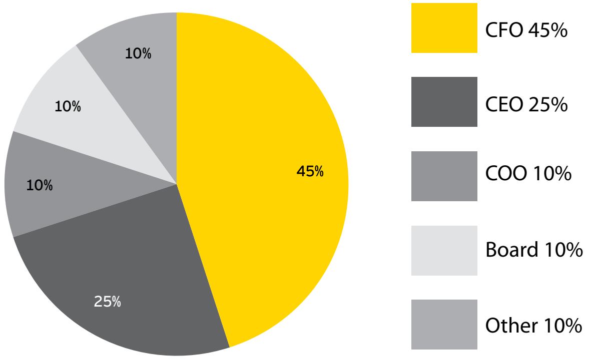
- "Hold back the Fed"
- Represent the US in international insurance forums, especially with the International Association of Insurance Supervisors
- Establish a common regulatory framework
- Develop an optional national charter
- Work with the Fed on capital standards based on a deeper understanding of insurance

There is broad consensus that the FIO should adopt the Hippocratic Oath — "First, do no harm." No CRO wants an additional layer of regulators or another set of conflicting and confusing reporting requirements. In the eyes of survey respondents, the opportunity for the FIO is to assist the industry in international forums and simplify the domestic regulatory regime.

### What CROs say:

- *"A strong role in overall prudential oversight by the FIO would allow the US to be well represented in international arenas and could help simplify regulation at home."*
- *"The FIO should address issues of solvency, tax issues and international holding arrangements, and leave rate, form and market conduct to the states."*
- *"We would like to see the FIO become a better alternative for systemic protection on insurance holding companies that own a bank ... producing a more relevant framework for insurance companies."*

## Q8. To whom do you report?




In the 2010 CRO Survey, participants predicted that within three to five years, the CRO position would be on par with the CFO. Two years after that forecast period, progress toward parity seems slow. Almost half of 2012 survey respondents reported that the CRO reports to the CFO, with a quarter saying the CRO reports to the CEO.

Current CRO reporting lines in insurance present a clear contrast with the banking industry, where the majority of corporate CROs report either directly to the board of directors or the CEO. Although the rule is not final, enhanced prudential standards proposed by the Fed for bank holding companies with US$50b or more in assets will require such a direct line of reporting. Fed actions highlight the role of the CRO as an objective, second line of defense for prudent risk management. As insurance CROs develop the methodologies, capabilities and organizational stature, they too will evolve into an independent second line of defense.

When asked how they could improve their current reporting arrangement, 40% responded that they were satisfied with the current arrangements and 20% expressed a preference for reporting directly to the CEO.

While more CROs will likely report to the CEO in the future, they already have ready access to either global or US boards. A full 65% of respondents answered that they report to the board or one of its committees (primarily an ERM, audit or risk committee) at least quarterly. Others reported that their access is unfettered.

The survey results suggest that current reporting models are an example of two diverging paths for CROs:

- CROs promoted from within from audit or actuarial groups are likely to report to the CFO and have oversight for a limited number of risks (typically insurance, catastrophic, Sarbanes-Oxley and operational). They are usually not responsible for investments, regulatory or credit risks.
- CROs coming from banking or capital markets are likely responsible for all major risks (credit, market, insurance, strategic, new product, emerging, regulatory and operational) and to report directly to the CEO or the board. Further, these CROs would serve as members of the executive leadership committee and play an active role in economic capital and risk quantification programs.

## Q9. What risk areas are you responsible for?

The responses to this question produced the greatest variation in the survey and provided a vivid, cross-sectional view into the many varied roles and responsibilities of CROs across the industry. Clearly, the CRO role is undergoing significant changes, but there is no precise job description today or definitive road map for the path ahead.

There was general agreement that a CRO is responsible for "all risks to the company," though interpretations differ regarding the definition of "all risks." Property and casualty, life, market, ALM, underwriting and credit risk were among the most common responses. Other survey participants cited operational, catastrophic, reputational, IT and emerging risks.

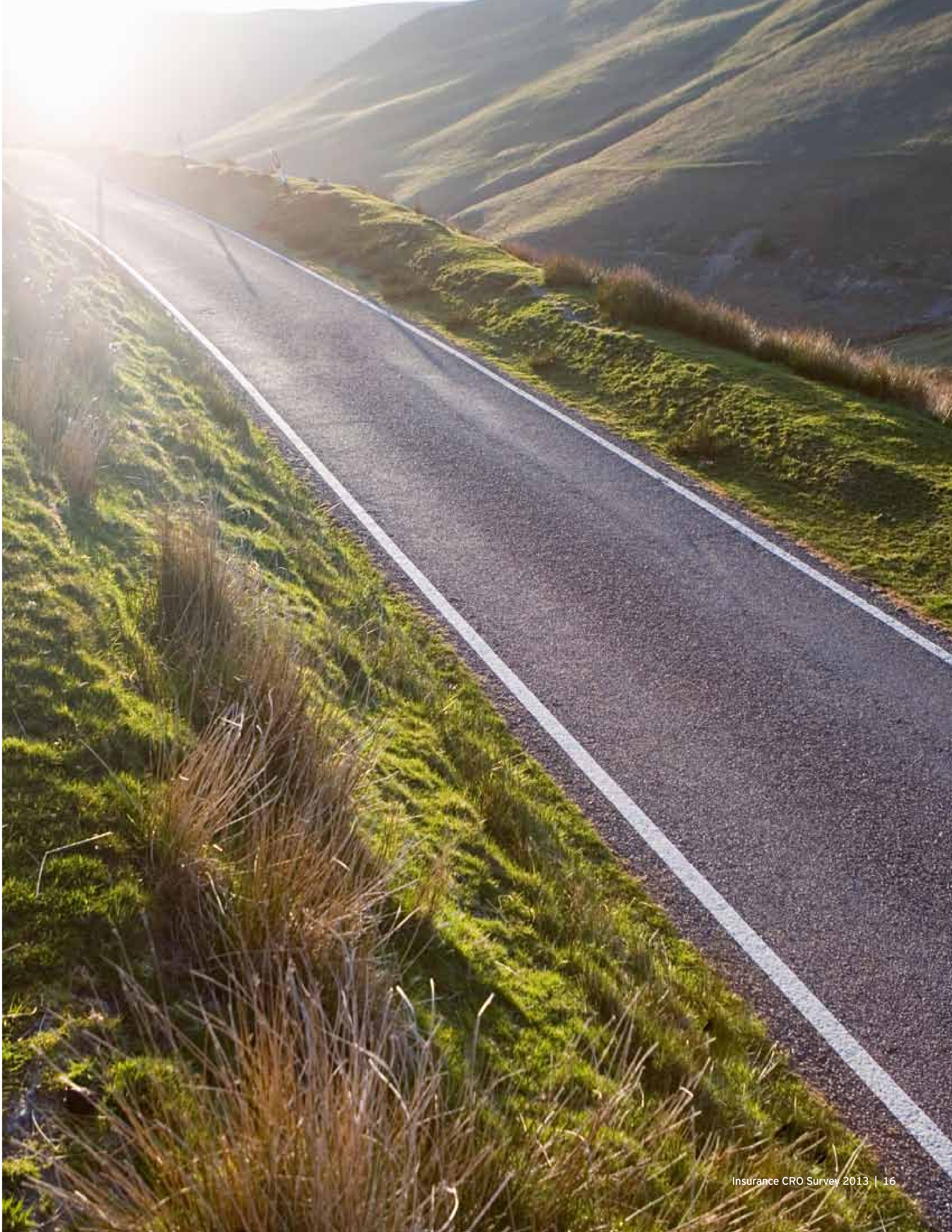
The impact of legacy risk reporting relationships was also apparent in the survey results. Respondents provided somewhat obvious answers, such as ERM and economic capital, but also mentioned internal audit, compliance, reinsurance, variable annuity hedging and catastrophic. In many cases, it appears old responsibilities have not been reassigned.

However, it is just as clear how quickly and significantly CRO roles and responsibilities are evolving. As the CROs continue to demonstrate value in these uncertain and turbulent times, they have taken on greater responsibilities for monitoring and mediating new threats. The combination of new and legacy responsibilities has left some CROs with an oversized workload. The situation is further complicated by the ambiguous lines of responsibilities between business unit and corporate CROs, and the existence of many different risk and non-risk committees on which CROs typically serve.

The large volume and diverse mix of responsibilities, coupled with a lack of industry benchmarks, make it difficult to precisely define the position. For some companies, the main role of the CRO seems to be to serve as an effective challenger to the business units and senior management. But with many of these new responsibilities just emerging, they have not been codified into a complete or final job description.

### What CROs say:

- *"We are involved with all of the risk categories in some capacity, but the ERM department specifically owns catastrophic risk, capital modeling (building and managing the model) and purchasing insurance coverage."*
- *"We work very closely with other groups and risk owners, such as underwriting, operations and investments."*
- *"Risk management decision making is primarily conducted by a number of risk committees, with different levels of specialty. The focus is on working with designated risk owners to create awareness of cross risks or correlated risks."*



## Q10. How do you quantify risks?

If there is one specific area that demonstrates the diversity of roles and responsibilities, it is in the area of risk quantification. Most CROs in insurance, like their counterparts in other financial service sectors, use a combination of qualitative and quantitative measures. However, unlike banks, slightly more than 60% use economic capital; for banks, this figure would be closer to 100%. In some cases, economic capital programs capture financial risk only. Operational risk is relatively new and infrequently accounted for in risk quantification. Similarly, many companies do not have a formal capital allocation program.

Respondents report the use of multiple methods to measure and monitor different kinds of risk, each at different stages of maturity and robustness. The most common methods include:

- Asset liability management
- Stochastic simulations
- Underwriting risks scenario analysis
- Stress testing
- Catastrophic modeling
- Pricing models
- Portfolio allocation
- Long-tail estimation
- Value at risk
- Reinsurance
- Risk/return analysis

Here again, organizations that have gone through SII appear to have a clear advantage, with broader, deeper and more advanced risk quantification programs. While the methods and capabilities vary widely, there seems to be a growing consensus on the importance of the numbers. More CROs report that the business understands that confidence in underlying risk numbers often equates to more confident decision making and an increased understanding of which risks to take.

### What CROs say:

- *"Risks are quantified through the economic capital model, including investment risks, catastrophic, ALM (IR), mortality and morbidity (UW risk). There is most confidence in using the outputs of these quantified risks."*
- *"Non-financial risks are not quantified, but are regularly discussed and tracked relative to broader risk principles."*

## Q11. How are the results of your risk quantification used?

The varying responses to this question are a function of the different maturity levels of economic capital and risk quantification across the industry. Companies with more advanced programs have economic capital results incorporated into explicit business unit performance metrics and key risk indicators. Companies with less developed programs are struggling to convince business-unit leaders of the validity of this approach and risk quantification programs more generally. The bottom line is that there is greater acceptance of risk quantification efforts at the top levels of the enterprise than at the business-unit level.

Risk measures and quantification outputs are used in a variety of areas and inform activities across the business. Survey respondents cited the following:

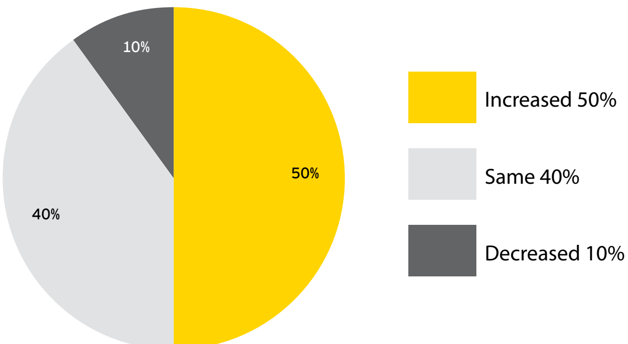
- Risk-adjusted profitability for both business units and products
- Reinsurance decisions
- Defining tolerances and limits on risk appetite
- Capital allocation to the states and business units
- Product design and pricing
- Risk-adjusted return on capital
- Risk budgets
- Risk diversification
- Balance sheet de-risking
- Executive compensation

It is clear that CROs are spearheading the application of risk quantification techniques and methodologies across the enterprise. The overall effects are an increased ability for managers to make risk-adjusted decisions and greater risk transparency for investors and stakeholders. Lastly, respondents see an increased confidence to take risks as an important benefit of a strong risk quantification program.

### What CROs say:

- *"Capital is allocated to the business units based on risk-based capital calculations. We take into consideration correlation benefits."*
- *"Capital allocation is used to drive pricing measures."*
- *"Confidence in the outputs and your ability to execute is key to using the results."*

## Q12. Compared with a year ago, has the size of your department increased, stayed the same or decreased? Compared with a year ago, would you say that hiring and retaining good talent is harder, easier or about the same?




Continuing a trend observed throughout the US financial services sector, staffing in the CRO office and related areas increased in 50% of respondents' organizations. It stayed the same in another 40%. Again, these results reflect the growing recognition of the need for risk management in insurance and the expanding involvement of CROs and risk leaders in new areas of the company. More practically, the growth can be seen as a function of the need for broader risk quantification and regulatory compliance efforts. With more work to do in the risk reporting space, insurers need more people to fill the roles.

Expanding workloads and increased responsibility mean demand for skilled resources and, potentially, a talent shortage. Obviously, insurance companies are in hiring mode when it comes to risk management. The top-priority skills are actuarial, credit, risk quantification and operational risk. In many areas of the country, CROs report difficulty in attracting qualified candidates, especially in the areas of compliance (ORSA) and risk quantification.

### What CROs say:

- *"Our corporate risk department has increased significantly, both in staffing and budget. The 25%-30% increase is expected to repeat next year."*
- *"Because they are in high demand, it is difficult to find talented risk professionals. However, once you find them, they are relatively easy to hire."*
- *"Many market risk professionals prefer to be in a transaction-based environment, as opposed to a second-line function."*

## Q13. Looking ahead three to five years, what do you think will be the biggest differences in the CRO role then compared with now?

While today's insurance CROs have different roles, responsibilities and organizational reporting relationships, a significant majority of respondents expect the role to grow in stature and importance in the near future. The increasing momentum of the CRO evolution is, according to respondents, due largely to industry drivers, including increased regulatory and reporting requirements, ongoing economic and political uncertainty, the increased sophistication of risk quantification tools and techniques, and, therefore, broader acceptance of those tools and techniques within the insurance industry.

**That CRO evolution will manifest itself in several ways, including:**

- More direct and frequent interaction with the business, as both a partner and a challenger. The CRO will work closely with business units to assess and adjust the risks inherent in their business plans, helping them improve the quality of their returns, and introduce more risk metrics into performance evaluations.
- More direct involvement with the board and senior leadership. The CRO will become more active with the executive leadership team and in long-term strategic planning.
- More focus on forward-looking activities. Stress-testing and ORSA will become prominent items on the CRO agenda.
- Greater independence of the function. As CROs build the risk infrastructure that insurers need for quantification, risk appetite, economic capital, reporting and risk/return reviews, the function will become stronger and more able to serve as an independent advisor to business stakeholders across the enterprise.

The bottom line is that insurance CROs will become more prominent spokespersons on risk issues at every level of the organization, while also engaging more frequently and directly with the business. In other words, they will no longer be viewed as an entity separate from the business, but rather as a function that's instilled into every dimension of operations.

### What CROs say:

- *"In the future, CROs will become more analytical, and expected to drive risk thinking at the portfolio level."*
- *"Increasingly, CROs will serve as strategic partners, and not viewed as external auditors."*
- *"The role will be more strategic, with CROs helping to determine where and when to hit the accelerator and focusing on the needs of the business."*
- *"It's the best job in the business, though I fear that it could dissolve into a mere compliance function."*

# Conclusion: The action plan ahead

As insurance CROs move ahead with a growing and diversifying set of responsibilities, they must prioritize their tasks. That will surely mean more direct engagement with the board and the CEO to determine not only which risks are of most importance to the business, but also what is included and excluded from their job description. One can not overestimate the need for the development of road maps for individual CROs.

A certain amount of clarity does not preclude the need for flexibility. The regulatory, economic and competitive landscape is changing far too quickly for CROs to expect a perfectly settled routine or static agenda anytime soon. And it is important to remember that the still-pending FIO report could re-sort all the priorities once again. In other words, flexibility will be a common attribute of successful insurance CROs.

Lastly, CROs need to customize their jobs to fit the needs of their organization, particularly as they relate to the overall risk management journey. Companies with different operational footprints, business objectives and risk management cultures will surely have different roles and responsibilities for their CROs. The bottom line is that while there is much more evolution to come, there is also ample evidence of opportunity for CROs across the industry.

Appendix

# Profile of participants

The 19 companies listed below participated in the survey. All interviews were conducted by phone through the months of November and December 2012.

- AAA NCNU Insurance Exchange
- Aflac
- Allstate
- Aviva
- CNA
- Fireman's Fund
- Great-West Life
- ING
- Manulife
- Munich Re
- Mutual of Omaha
- Nationwide
- Pacific Life
- RGA
- State Farm
- Transamerica
- Westfield Insurance
- XL Group
- Zurich

**Ernst & Young wishes to express its appreciation to those who took the time to participate in the survey.**

# Appendix

The distributed survey included the following questions:

1. Overview
   A. What was your most important accomplishment over the past year?
   B. Which area do you see devoting significantly more attention to in the next 12 months, compared with the last 12?
   C. What do you think are the biggest risks/challenge facing the insurance industry?

2. Regulatory
   A. What specific regulations, actual or pending, will present the biggest implementation challenge?
   B. Do you currently have specific plans in place for meeting NAIC's ORSA requirements?
   C. Are there any regulations that you would like to see the industry adopt?
   D. What should be the role of the FIO?

3. Organization
   A. Who do you report to?
   B. What risk areas are you responsible for?
   C. What is your access to the Board?
   D. How can the organizational structure be improved?

4. Risk quantification
   A. How do you quantify risks?
   B. Do you have a company-wide economic capital program? What types of risks (market, counterparty, operational) does it capture?
   C. How are the results of your risk quantification used?

5. Outlook
   A. Compared with a year ago, has the size of your department increased, stayed the same or decreased? Compared with a year ago, would you say that hiring and retaining good talent is harder, easier or about the same?
   B. Looking three to five years out, what do you think will be the biggest differences in the CRO role then compared with now?

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