A mature approach to ERM

Enterprise risk management is not merely a compliance exercise; it is a useful process that realises a value proposition, writes Safder Jaffer.

Enterprise Risk Management (ERM) appears to be the new buzzword amongst insurance management circles in the region. All the insurance conferences have an ERM session, CEOs are pushing their management teams on it and companies appear to be scrambling to ensure they have an ERM framework in place.

Yet the motivation behind this latest ERM fervour, which is still in its infancy in the GCC markets, appears to be mere compliance with 'tick the box' exercises. Companies fail to understand the true value and potential of having a robust ERM framework in place. A good ERM programme is meant to generate significant business value – and it is only those companies that take a mature approach to risk management that will achieve a competitive advantage from it.

WHAT IS ERM?

All businesses are exposed to risk – it is an integral part of any business. There is no business or industry that is completely risk proof, including the insurance industry. Therefore, the concept behind an ERM framework in its simplest form can be summarised as a simple two-step process:

1. Identify and categorise all the risks that have the ability to impact a business and assess them in terms of likelihood and magnitude of impact. The logic behind this first step is clear – a company cannot mitigate its risks if it doesn't know what they are.
2. Formulate a response strategy to those risks – a tangible plan of action for lowering the risks to achieve greater business robustness to attain appropriate profit margins and risk reward balance.

It therefore becomes clear that ERM has to be a continuous process which flows throughout an organisation and involves people at every level in it. At its core, ERM is

SAFDER JAFFER, MD AND CONSULTING ACTUARY – MIDDLE EAST & AFRICA, MILLIMAN

fundamentally about helping managements understand and communicate to others, the threats and opportunities accepted by following their business plan and to manage them in such a way that achieving goals becomes more certain. Successful ERM programmes should be driven by the following value drivers:

» Active stakeholder management of inherent risks
» Operational excellence
» Integration into performance management
» Capital efficiency

THE DRIVE FOR ERM

Unfortunately, many GCC insurance companies fail to recognise that an ERM programme is meant to generate significant business value. They still view ERM very much as just a regulatory compliance exercise or a rating agency requirement – these two factors being the primary drivers for ERM growth in the region.

REGULATION

The need for a robust ERM framework was highlighted during the last financial crisis as insurers with better ERM policies survived the turmoil in a stronger position than those with weak ones. As realisation of the value of ERM frameworks began to dawn, regulators in various countries observed that the firms under their charge didn't fully understand the risks involved. They began to seize the initiative to ascertain that companies within their domain would better manage their risks and get their houses in order - namely, that they could no longer simply depend on investment income to maintain their profitability and solvency.

Amongst the regulators in the six GCC countries, SAMA, the Saudi Arabian regulator, has taken the lead by actually issuing risk management regulations for companies to better manage their risks. Oman's Capital Market Authority put together a workshop in June on the topic to educate the sector about ERM best practices in another solid step toward raising awareness of how critical effective ERM is to the health of the industry. In addition, the UAE and Qatar are in the process of formulating their own rules that will take effect in the coming years.

RATING AGENCIES

Rating agencies are also pushing the ERM message by considering the quality of risk management when grading companies. They are employing strong words in urging them to develop more robust risk management. Having weak risk management is a key factor in keeping insurers' ratings below their potential, which in turn increases their financing costs and hurts profitability.

Those companies, who approach ERM as just another compliance exercise, hire consultants who set up the standard risk registers and provide simple ERM platforms. Management typically feels content when these are put in place. The reality, however, is that rating agencies are barely impressed by such initiatives that appear fancy on paper but in essence miss having a robust ERM framework in place.

It is unfortunate that shareholders, who could potentially be another driver for change, are still in slumber to drive home the ERM message. On the positive front however, gradually regulators are pushing for actuaries to present their findings directly to their Board thus educating them in the process to understand and own their risks.

ERM MATURITY IN THE GCC

ERM is still in its infancy and development stage in the GCC, with growth largely being driven by the aforementioned regulatory and rating agency compliance requirements. There are a number of stages towards reaching a fully mature enterprise risk management framework, wherein a company realises that ERM is a key factor to driving business growth and in which risk management would drive business decisions. Ⓟ