Foreword

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The insurance industry is being both pushed and pull ed toward Enterprise Risk Management (ERM). On one hand, regulators and rating agencies are pushing insurers and reinsurers for ERM analysis to verify solvency and effective risk management. On the other hand, ERM is increasingly being recognized by management as simply a good idea. Industry leaders are recognizing that an integrated basis can add value to a corporation.

While the concept of ERM makes perfect sense, implementing enterprise-wide measurement, analysis and risk management practices is not an easy task. It is particularly difficult for companies who assume portfolios of risk that originate with others. For insurers and reinsurers, it is complex, broad in scope, rapidly evolving and ultimately requires knowledge of advanced risk modeling techniques.

So how do you get started? What are the best practices? Where are the pitfalls?

Within this book, we have assembled years of research and practical applications in ERM — from leading specialists in the field — to help our insurers and reinsurers address this important issue. It is a "practical" guide to ERM — a "how-to" book on risk modeling techniques.

Even if you are not planning to adopt a comprehensive Enterprise Risk Management program, risk managers can still draw on approaches from the ERM world. Here are a few lessons that we believe are helpful to the overall management of a company:

- First, "experience the future." If you have already considered scenarios other than what is "expected" in the firm's strategic plan and budget, you will be better prepared to address the "unexpected" when the real world does not conform according to plan.

- Second, follow through with ERM-generated contingency plans and avoid being a slave to the budget plan. Regulators and rating agencies are looking for active use of ERM in planning and management decisions. When the world does not behave as planned, poor decisions may be made if management feels obligated to "make a budget" that is unreasonable given environmental changes.

- If ERM is to drive real action, the need for quality data to underpin risk models is an obvious third lesson. Without accurate, detailed data, we cannot have confidence in our models, no matter how sophisticated they might be. And without confidence, it would be difficult to justify decisions with any conviction about the outcomes.

- Finally, recognize the need to identify and manage correlated risks. Large events, economic scenarios and industry shifts can have a "knock-on" effect that magnifies loss. ERM can help reveal relationships between lines of business and categories of risk that might otherwise be overlooked.

While these are but a few of the useful lessons discussed within these pages, we are confident that readers will find numerous practical examples for managing their business using ERM methodologies.

Given the fast-growing field of ERM, our hope is that the depth and comprehensive nature of the modeling techniques contained herein will prove to be a timely and valuable resource for those working in this field.

While the key audience for this book are expected to be actuaries requiring technical assistance in creating ERM-type models for their companies, those in top management can gain a fuller appreciation of the topic by reading Section 1, the early sections of Sections 2 and 3, and Section 4. A perusal of the other chapters, while daunting to the mathematically challenged, nevertheless provide some sense of the process and tasks involved in creating workable models for ERM decision making.