

Emerging Risks

*Presentation to the Institute of
Risk Management, Solvency II
Special Interest Group*

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Agenda:

- *What is meant by “emerging risks”?*
- *Why is it such a difficult issue?*
- *Why is it an emerging issue?*
- *Some examples of good practice*

What is meant by “emerging risks”

- Hard to define – so, hard to identify and manage – this definition from Swiss Re is helpful:

Identifying emerging risks

Reinsurers today are operating in a risk landscape that is shifting ever more rapidly. Charting emerging risks and opportunities in a pre-emptive way is an important element of Swiss Re's integrated approach to risk management.

- How we define emerging risks** We define emerging risks as newly developing or changing risks which are difficult to quantify and which may have a major impact on an organisation. We investigate these risks because of the substantial potential impact on our business.
- Key drivers** Key drivers of the changing risk landscape include new economic, technological, socio-political and environmental developments as well as the growing interdependencies between them which can lead to an increasing accumulation of risk. In addition, there is a changing business environment to consider: liability and regulatory regimes continue to evolve, stakeholder expectations are strengthening and risk perception shifting.
- Reducing uncertainty** The key is to reduce uncertainty and thus help diminish the volatility of business results. While risks today are assessed largely reactively based on loss experience, a faster pace of change requires a more anticipatory approach. To achieve this, we strive to translate risks associated with high uncertainty into a quantifiable measure.

Emerging risks – what’s so hard?

- It is very difficult to “think the unthinkable”
 - The human mind is conditioned by our own experience, and we use our known universe as a reference point for the unknown
- But “emerging risks” challenges us to identify, qualify, quantify and assess the probability of things beyond our experience
 - Just how bad could something be, and how likely is it to happen?
 - And what is that “something”?

“ [T]here are known knowns; there are things we know we know.

We also know there are known unknowns; that is to say we know there are some things we do not know.

But there are also unknown unknowns – there are things we do not know we don't know. ” —
Former [United States Secretary of Defense Donald Rumsfeld](#)

Some insurance context – what might we call emerging risks?

- As an industry, we already have some pretty good tools and techniques for dealing with some types of emerging risk
 - E.g. How we provision against unknown quantification of known loss events
 - And how we set IBNR
- We are less good at identifying “the next big problem” – because that is harder
 - Some suggest that the more expert you are, the harder it is to imagine the unknown
- Emerging risks covers unknown cost of known events / risks, and unknown cost of unknown risks
 - But it isn't quite that simple

Some examples (emerged, emerging, yet to emerge...)

- Hacker attacks / cyber crime?
- Social networking misuse?
- Bedbugs?
- Volcanic ash?
- Global economic meltdown?
- Political risk?
- Competitor activity?
- New market entrant that reinvents the product?
- New distribution channels / methods of distribution?
- A combination of events that, individually, are not a threat?

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The CSFI survey of the
risks facing insurers

In association with



pwc

CSFI

Centre for the Study of
Financial Innovation

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(2009 ranking in brackets)

- 1 Regulation (5)
- 2 Capital (3)
- 3 Macro-economic trends (4)
- 4 Investment performance (1)
- 5 Natural catastrophes (22)
- 6 Talent (-)
- 7 Long tail liabilities (10)
- 8 Corporate governance (17)
- 9 Distribution channels (16)
- 10 Interest rates (11)
- 11 Political risk (18)
- 12 Actuarial assumptions (9)
- 13 Managing costs (14)
- 14 Management quality (13)
- 15 Risk management (6)
- 16 Reputation (15)
- 17 Back office (24)
- 18 Retail sales practices (25)
- 19 Complex instruments (8)
- 20 Climate change (28)
- 21 Reinsurance (20)
- 22 Fraud (23)
- 23 Terrorism (26)
- 24 Product development (29)
- 25 Pollution (34)
- 26 Managing mergers (31)

Why is “emerging risks” an “emerging issue”?

- Sometimes, there has to be a compliance incentive / requirement for an issue to receive focus:
 - **SII Directive (Art 41):** “The supervisory authorities shall have appropriate means, methods and powers for verifying the system of governance of the insurance and reinsurance undertakings and for evaluating emerging risks identified by those undertakings which may affect their financial soundness.”
 - **FSA IMAP CofA (echoing Commission’s Level 2, and SII Directive itself):** “F4: Risk management process and risk profile (emerging risks) – Please explain and provide evidence of how your risk management function identifies and assesses emerging risks and describe the processes or procedures followed in such circumstances”
- From experience, this is one of the less well-addressed elements of the industry’s SII work
- But we can expect good practice to be developed very quickly, and to become a necessity

Some good practice thoughts:

- What risks have emerged over the last 1/3/5/10 years?
 - Would our current or planned future processes, controls and organisation have identified those risks and led to adequate early management actions?
- Who is ultimately responsible for emerging risks, and what do they actually do?
- What kind of emerging risks have others identified – are these relevant to us?
- What processes do we have for identifying, quantifying (severity / frequency, or impact / likelihood) emerging risks?
 - How often do we refresh the emerging risks log?
 - And are we confident that we would then take appropriate actions to avoid / control & mitigate them?
 - How do we report hits and near misses internally, what kind of challenge is provided?
 - Do we really take emerging risks into account as part of our decision-making framework, business planning and corporate objective-setting?
 - Do we link our emerging risks work to our Reverse Stress Testing?

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