Safe-guarding Against Strategic Risks

A Progressive Approach to Managing Risk

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Two Starting Premises

1. InsurTech while important and potentially transformative will morph into or evolve to RiskTech

2. The digitization of the Risk Profile will transform the job of risk leaders
A Strong Migration Toward Strategic Influence & with Risk as Key Driver of Ultimate Success

**High Perf. Risk Mgmt**
- **Focus**: Long term success
- **Scope**: Mission focused; Embedded Risk Mgmt Practices; Risk as Differentiator
- **Advanced solutions**

**Advanced Risk Management**
- **Focus**: Short term success
- **Scope**: Mitigation of Controllable Risks/Manage Risk as an Expense

**Traditional Risk Management**
- **Focus**: Insuring the bad things
- **Scope**: Risk Transfer/Insurance/Loss Prevention/Mitigation of Insurable Risks

**Strategic Success**

**Operational Success**

**Enhanced & Broadened**

**Fundamentals**

**Specific Business Needs**

**Value**

**Time**
DO SOME RISKS MATTER MORE THAN OTHERS?
What is Strategic Risk?

“The array of external events and trends that can devastate a company’s growth trajectory and shareholder value.”

“The key to surviving strategic risks is knowing how to assess and respond to them.

Adrian Slywotzky & John Drzik, Oliver Wyman

Source: Countering the Biggest Risk of All By Adrian Slywotzky & John Drzik - HBR
The Risk Type Spectrum

**Strategic**
- Acquisitions
- Business Model
- Competition
- Demographic
- Brand
- Disruptive innovation
- Market.

**Operations**
- Customer service
- Infrastructure
- Processes
- System capabilities
- Talent
- Technology

**Financial**
- Capital
- Cash flow
- Credit
- Debt obligations
- Foreign exchange
- Liquidity
- Etc.

**External**
- Economy
- Environment
- Geopolitical
- Regulatory
- Tax policies
- Weather events
- Etc.

AN ENTERPRISE RISK MANAGEMENT SPECTRUM
1. **The rapid speed of disruptive innovations** and new technologies within the industry **may outpace the organization’s ability** to compete or manage risk appropriately.

2. **Resistance to change** could **restrict** the organization from making necessary **adjustments to the business model** and core operations.

3. The organization may **not be sufficiently prepared to manage cyber threats** that could significantly disrupt core operations and damage its brand.

4. Regulatory changes and scrutiny may heighten, noticeably affecting the manner in which organizations’ products or services will be produced or delivered.

5. The organization’s culture may not sufficiently encourage timely identification and escalation of significant risk issues that could affect core operations and achievement of strategic objectives.
Top Risks of 2018

6. Succession challenges and the ability to attract and retain top talent may limit the ability to achieve operational targets.

7. Privacy, identity management, and information security risks may not be addressed with sufficient resources.

8. Economic conditions in markets the organization currently serves may significantly restrict growth opportunities.

9. **Inability to utilize data analytics to achieve market intelligence** and increase productivity and efficiency **may significantly affect core operations and strategic plans**

10. **Companies that were not “born digital” face significant operational challenges**

Source: NC State Univ and Protiviti Survey
The Strategic Risk Priority: Beyond Testable Controls

### Root Causes of Decline

Market Capitalization Decline Drivers
Top 20% of Fortune 1,000 (1998-2009)

- This analysis looks at root causes underlying market capitalization declines of 50% or more in a single year.
- Percentages refer to frequency of occurrence of each factor in the sample population.

#### Strategic Risks: 68%
- Decline in Core Product Demand
- Poor Acquisition/Merger Integration
- Competition Infringement on Core Market
- Inability to Identify Asset Price Bubbles
- Destructive Price War
- Undersized Partnership Risk
- Inadequate Diversification
- Investor Loss of Confidence
- Senior Management Turnover
- Failure to Expand Alternative Revenue Sources

#### Operational Risks: 13%
- Poor Demand Forecasting
- Commodity Price Decline
- Poor IT Integration
- Regulatory Conflicts
- Cost/Lawsuits/Litigation

#### Legal and Compliance Risks: 6%
- Accounting Misrepresentation
- Admin/Financial Fraud
- Poor Financial Reporting
- Financial Restatements

#### Financial Risks: 12%
- Excessive Financial Leverage

Source: Corporate Executive Board
Choosing Your Risk Range Focus

Expected Losses

<<< Typically Uninsurable >>>

Typically Insurable

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EMERGING RISKS: CRITICAL TO THE STRATEGIC PLAN HORIZON AND MISSION ACCOMPLISHMENT
A VUCA World

• **Volatile**: nature, dynamics and speed of change

• **Uncertainty**: Lack of predictability, subject to surprises

• **Complexity**: Multiplex of forces, confounding issues, chaos and confusion

• **Ambiguity**: Haziness of reality, mixed meanings, potential for misreads
What is an Emerging Risk?

- Those issues that have not manifested themselves sufficiently to be managed using the tools commonly applied to more developed exposures. They are “those risks an organization has not yet recognized or those which are known to exist, but are not well understood.

RIMS’ “Emerging Risks and ERM

- A condition, situation or trend that could significantly impact the Company’s financial strength, competitive position or reputation within the next 5 years. Emerging risks involve a high degree of uncertainty. It is unclear where an emerging risk will land on the loss curve.

Anonymous actuary
Traits of Emerging Risks

- High Level of Uncertainty
- Lack of Consensus
- Uncertain relevance
- Difficult to Communicate
- Difficult to Assign Ownership
- Systemic or “business practice” issues

“Risk sensing technologies can also be useful in identifying and tracking potential strategic risks. And there is a huge potential to combine machine analysis with human analysis to scan large amounts of information, identify signals of potential disruption that are still very weak and look for connections that would be very difficult for individual analysts to do. Using these tools, organizations should be able to monitor their environment for those signals, or changes, both inside and outside the company. Such signals could be pointing to new technology, new regulation, new social trends and new customer behaviors.”

Andrew Bleu, MD Deloitte
Strategic Risk Practice
What Management & Boards Want Most from Risk Leaders

Risk is an increasing priorities for execs and boards who seek:

- Understanding what **risks are most threatening** to mission accomplishment
- Connecting **actionable risk information** to goals & strategy
- Managing critical **risk interdependencies**
- Getting ahead of **emerging risks**
- Fostering a strong ethics and risk culture
- Addressing **low-frequency, high-impact** risks proactively
- Providing **creative solutions** for key risks not effectively mitigated
Critical Considerations for the Future State

- **Disruptors** are radically shifting organizational risk profiles
- Risk managers are behind the curve on the **digitization of risk**
- **Technology** is one of the **least understood** risks by risk mangers.
- Cyber risk, like other new or emerging risks are often treated only with insurance
  - More **creative thinking** is required about **non-insurance solutions**
- Insure-tech represents one of the great disruptors of the traditional insurance mitigation paradigm – **“risk-tech” is the next phase**
- An **ERM approach** represents the key driver for the evolution of risk strategy that enables:
  - Responding more quickly and effectively to **all risk types**
  - Using **creative, targeted tech solutions** that would have never previously been needed/considered and that are now becoming mandates
THANK YOU
Chris Mandel
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& Director, the Sedgwick Institute

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Christopher E. Mandel, RF, RIMS-CRMP, CPCU, ARM-E
SVP, Strategic Solutions, Sedgwick, Inc. &
the Director of the Sedgwick Institute

Christopher E. Mandel is the SVP for Strategic Solutions at Sedgwick and the Director of the Sedgwick Institute. In both roles he is engaged in helping Sedgwick chart its future through the long term planning for products, services and strategic solutions for this claims and productivity management firm. He is also co-founder and EVP, Professional Services for rPM3 Solutions, LLC as well as founder and president of Excellence in Risk Management, LLC. both independent consulting firms specializing in governance, risk and compliance, with a special emphasis on enterprise risk management. rPM3 Solutions holds a patent for a unique risk measurement process known as ARQ™. Prior to electing early retirement and for ten years from 2001-2010, Mr. Mandel was head of enterprise risk management for USAA Group, a $165 billion diversified financial services organization. At USAA, he designed, developed and led the enterprise-wide risk management and corporate insurance centers of excellence. He also served as President and Vice Chairman, Enterprise Indemnity CIC, Inc., an Arizona based alternative risk financing facility.

Mr. Mandel has more than 25 years of experience in risk management and insurance in large, global corporates. He has pioneered the development of cross-enterprise risk management capabilities resulting in S&P rating USAA as “excellent and a leader in ERM” from 2006 through 2010. In 2007, Treasury and Risk Magazine bestowed the Alexander Hamilton Award for “Excellence in ERM” on USAA. Mr. Mandel has been a long term senior leader in the Risk and Insurance Management Society including being elected President and Chief Risk Officer and was named Risk Manager of the Year in 2004. He also received RIMS’ Goodell Award (2016) for lifetime achievement.

Mr. Mandel's deep, wide and diverse experience in all facets of risk management and insurance allows him to offer those interested in managing risk with excellence to engage him to provide everything from a comprehensive strategy and complete ERM framework to targeted guidance, tools, techniques and/or training. Mr. Mandel’s innovative approach to making risk a key strategically placed and results oriented function results from solidly connecting risk management outputs to a company’s key performance metrics and ultimately, mission accomplishment.

Mr. Mandel received his B.S. in Business Management from Virginia Polytechnic Institute and State University and an MBA in finance from George Mason University. He holds the CCSA, CPCU, ARM and AIC designations and is a frequent industry speaker, teacher and writer. He writes the “Risk Innovation” column for Risk and Insurance magazine and in 2008 was elected a member of Risk Who's Who (RWW). He also wrote the Ask a Risk Manager column for Business Insurance from 1996 through 2008.

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Chris’ Risk Quips

- Why would you invest in and prioritize risk management if it didn’t directly affect the success of organizations?
- I’m not sure a risk with an “expected value” is really a “risk” when you consider that risk is ultimately defined as uncertainty.
- Risk managers don’t own risk but enable risk owners to effectively manage their risks.
- Emerging risks may or may not be black swans, however, they should be on the radar of every senior leader.
- Risk leaders need to be telling senior leaders about what they don’t know, not what is so often obvious and perfunctory to them.
- A risk is not a risk unless it affects decision-making.
Chris’ Risk Quips

- All decisions entail some element of risk; the difference is only a matter of degree.
- Innovation is critical to success in today’s global economy; you can’t innovate without taking risk.
- While insurance is an important element to successfully transacting business, uninsurable risks are actually the most potentially destructive to organizational value.
- Organizational resilience and enabled innovation should be the highest goals of risk management.
Value Destruction: A Threat to Mission

From the AUDIT DIRECTOR INC.®
of the FINANCE AND STRATEGY PRACTICE
www.ad-executiveboard.com
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Source: Corporate Executive Board
Value Killers Updated

- High impact, low frequency risks
- Correlated or interdependent risks
- Liquidity risks
- M&A related risks
- Culture and compensation risks
- Risk of failing to innovate

Source: Deloitte’s Value Killers Revisited
Choosing Your Risk Range Focus
The Risk Attitude Hurdle

High appetite for risk

Image makers
- Sales
- Marketing

Adventuresome visionaries
- CEO
- Line Executive
- Strategist

Risk profile

Low tolerance for risk

Daily operators
- Internal Auditor
- Risk Manager

Operational leaders
- CIO
- CFO
- COO

Organizational mind-set

Tactical → Strategic

Strategy vs Strategic Risks

• **Strategy** is a complete plan of action for whatever situations might arise in achieving an organization’s goals within the established time. An organization's strategic plans will determine the actions the organization will take at any stage of the planning period as circumstances change.

• **Strategic risks** are those internal or external uncertainties, *whether event or trend driven*, which typically have biggest impact an organization’s strategies and/or the implementation of its strategies.

[https://www.youtube.com/watch?v=qIob4YZBp4k](https://www.youtube.com/watch?v=qIob4YZBp4k)

Source: Risk Management Society, Inc.
EMERGING RISKS: CRITICAL TO THE STRATEGIC PLAN HORIZON
“There are **known knowns**. These are things that we **know that we know**. There are **known unknowns**. That is to say, there are **things we know we don’t know**, but there are also **unknown unknowns**. These are **things we don’t know we don’t know**.”

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- High Level of Uncertainty
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Steps to Getting Ahead of Emerging Risks

- Establish a specific process to uncover the unknown or poorly understood threats to businesses
- Bringing key stakeholders together to address the risks efficiently & sensibly
- Facilitate the drive for consensus among contributors to scenario planning
- Review and eliminate or defer low relevance risks
- Leveraging emerging risk processes for competitive advantage
- Bring forth and highlight risks that lend themselves to exploitation
RISK APPETITE STRATEGY
Key questions addressing risk appetite strategy

- How much risk are we taking?
- How much risk can we take?
- How much risk do we prefer to take?
- How much risk do we need to take to reach our strategic goals?
- Which risks do we want to take and which risks are unacceptable to take and why?
- What is the gap between capacity and need?
- If the gap is large between need and capacity, how and which strategies need to be modified?
- What is the cost/benefit of key gap closing activities?
Align Appetite & Tolerances to Business Priorities

Risks should tie to the processes of key products or services
Risk Exposure, Appetite and Tolerance
A VUCA World

- **Volatile**: nature, dynamics and speed of change
- **Uncertainty**: Lack of predictability, subject to surprises
- **Complexity**: Multiplex of forces, confounding issues, chaos and confusion
- **Ambiguity**: Haziness of reality, mixed meanings, potential for misreads
Requirements of a VUCA World

- Anticipate the unexpected
- Adapt to changing conditions
- Maneuver through obstacles
- Be decisive on critical issues
- Be ready and able to change course with limited information
Macro-level Categories to Consider

- Geopolitical
- Societal
- Technological
- Cultural
- Systemic
- Economic
- Environmental
Two Key Risks for Every Strategy

- **Cyber Risk** – move out of a compliance-driven approach to cyber security to a risk-based approach which requires:
  - Knowing where your critical elements are
  - Knowing your cyber landscape/profile
  - Knowing the types of adversaries you’re facing

- **Terrorism** - The stand alone terrorism market can offer coverage against terrorism and political violence but….
  - Predictability remains an issue
  - Consider the black swans of terrorism
  - Consider truly company ending events
  - Develop non-insurance mitigations
“Uninsurable” Risks and the Plan

Nuanced and Complex

- Regulation
- Reputation
- Trade Secrets
- Political Risk
- Pandemic Risk
MEASURING RISKS: KPI’S AND KRI’S
Key Performance Indicators (KPIs)

KPI’s measures progress toward an organization's goals, provide an attainable standard for a specific activity, and gives the focus or direction the activity is to take.

- KPIs help **gauge the results** of activities critical to the success of an organization.
- Each organization will establish a level of **adherence** that will be tolerated in meeting its KPIs.
- For an organization, a KPI measures the **performance** of a specific activity at a predetermined level or amount.
- It measures the **progress** an organization has made toward attaining its goals within a specific amount of time.
Key Risk Indicators & the Corporate Scorecard

Organizations use key risk indicators (KRIs) to plan for and respond to risk.

- Effectively manage its strategic risks by identifying them before incidents occur that can lead to losses.
- KRIs can reveal emerging risks, identify risk exposure levels, and detect changes or trends in existing risk exposures.
- While KPIs measure an organization's progress toward achieving its objectives, KRIs measure risk and volatility related to achieving those objectives.
- In contrast to KPIs which are lagging in nature, KRIs are always a leading (predictive) indicator.
- Provide objective, quantifiable information about emerging risks and trends that can affect an organization's success.
- Can reveal an upward trend in the level of a risk.
CAPABILITY, MATURITY & RISK INTELLIGENCE
Risk Capability as a Feeder to Strategy

Four Areas of *Improvement* Necessary for Risk-Strategy Success

1. Aligning, if not integrating business strategy with risks
2. Adopting and applying dynamic risk appetite strategies/frameworks
3. Managing the diversity of stakeholder expectations
4. Improving risk sensing, monitoring and reporting

Source: PwC’s Re-evaluating how your company addresses risk
## Attributes of “Risk Intelligence”

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<td>Ad-hoc/chaotic;</td>
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- **Tone set at the top**
- **Policies, procedures, risk authorities defined and communicated**
- **Business function**
- **Primarily qualitative**
- **Reactive**
- **Integrated response to adverse events**
- **Performance linked metrics**
- **Rapid escalation**
- **Cultural transformation underway**
- **Bottom-up**
- **Proactive**

- **Built into decision-making**
- **Conformance with enterprise risk management processes is incentivized**
- **Intelligent risk taking**
- **Sustainable**
- **“Risk management is everyone’s job”**

**Source:** Deloitte
Steps to a “Risk Intelligent” Enterprise

- Establish a framework, policy and process for assessing and managing risks
- Identify key risks and vulnerabilities, the plans to address them.
  - Assess where risks could impact significant value
- Establish your risk appetite, how much you’ve taken on and whether you need to take more or less risk to achieve plan
- Decide who, inform and hold accountable those who have the authority to take risk
- Enable and resource risk-taking capabilities on an integrated and sustainable basis

Based in part on Deloitte’s Risk Intelligent Enterprise Model
Components of Risk-Strategy Alignment

Mission Accomplishment

Corporate Business Strategy

1. Collaboration Among Leaders
2. Risks Matched to Objectives
3. Measurement Alignment

Risk Management Strategy
Alignments and Overlaps

**All Risk Stakeholders**
Narrow, Specific Risk Interests

**Strategy Planning**
Determine the Goals Needed to Achieve the Plan

**Control Risks to Success**

**ERM**
Enable Risk Identification, Assessment and Management

**Collaborate on Risks to Objectives**

**Achieve Objectives**
8 Steps to Integrating Risk and Strategy

1. Build meaningful relationships with planning leaders
2. Demonstrate to planners the direct relationship between specific key risks and the strategic goals of the firm
3. Demonstrate to planners the ability to treat these risks including the clear understanding of the cost benefit of mitigation
4. Articulate examples of how new or greater risks taken can create value
5. Identify and challenge fundamental assumptions
6. Identify and look for signals regarding unexpected events
7. Clarify whether these events are risks or opportunities or both
8. Develop a plan with options that allow for resiliency in adversity through agility

Source: Deloitte’s Shaping a Risk Intelligent Strategy
Key Take-a-ways: Considerations for more effective risk management

- Appetite, Tolerances and Materiality Understood
  Identify the risks the board and sr management need to take, know and manage most effectively

- Risk Strategy and Profile Defined
  Drive a consensus around risk strategy, the risk profile and ensuring risk a key consideration in planning/decision making

- Capable, Informed & Aligned Risk Stakeholders
  Involve the right stakeholders in an effective and coordinated risk strategy that adds value in executing corporate strategy

- Clear, Understandable Risk Process
  Enable board members, managers, and employees to understand and be appropriately engaged in the risk process

- Embedding Risk Intelligence into Culture – Build Resilience
  Integrate risk management into all key business processes, including planning, operating, and financing activities