Overview of ERM Assessment Viewpoints (June 2016)

Overview

ERM assessment main category	Overview	Sub-category
Risk Culture & Risk Governance	Examine to what extent a risk-based management approach focusing on the risk-return balance of insurance products, etc., rather than a sales-focused approach, is entrenched in insurance companies among the management and employees.	ERM's position in management strategies, the management's awareness, development of risk culture
		ERM organization & system
		Development of risk management policies
		Setting, disseminating & entrenching risk appetite framework
		Audit system
Risk Control & Capital Adequacy	Examine the system where financial soundness, at the core of business management, is ensured through the management of risk tolerance level/risk limit.	Ensuring company-wide (group-wide) financial soundness
		Ensuring financial soundness for each risk category and business line
		Status of stress testing
Risk Profile & Risk Measurement	Examine risk quantification methodologies and approaches to capture unquantifiable risks that support ERM.	Risk identification & analysis, appropriateness of targets
		Risk quantification and aggregation methodologies
		Measures against unquantifiable risks, such as liquidity risk
		Measures against emerging risks
		Model governance system
Application to Business Management	Examine whether insurance companies operate sound and profitable businesses through ERM, such as capital allocation, etc., and through risk-return analyses of insurance products.	Confirmation as to mid- to long-term capital adequacy, incorporation of ERM in setting management plans and target ROEs
		Implementation of the capital allocation program, etc.
		Establishment of profitability indices and evaluation of performance thereof
		Application to product development, premium rating, business decisions, etc.

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Risk Culture & Risk Governance	ERM's position in management strategies, the management's awareness, development of risk culture	・Insurance companies provide indemnification for losses resulting from natural disasters and provide super-long life/medical security, making their risk profile complex. Since insurance companies manage assets as banks, etc., they are also exposed to investment risk. As such, insurance companies are required to balance risk and return appropriately, remain financially sound to make insurance payments adequately, and distribute profits to policyholders and shareholders appropriately. ・In this regard, the management of insurance companies themselves should recognize the importance of ERM and endeavor to spread throughout the organization a risk culture where various operations are performed from the perspective of risk-adjusted return.	・ERM matters, such as the risk appetite, resulting from the decision making on risk-adjusted return, are disseminated thoroughly within the organization; or a system to disseminate such matters is in place. ・ERM is utilized in making important management decisions, in such a way that the management plan is formulated based on ERM and the progress of the management plan is reviewed regularly by the board of directors, etc. ・Performance evaluation is conducted utilizing the realized risk-adjusted return. ・Fulfilling explanation on the status of ERM is given externally.	・While the risk appetite, etc. is not disseminated company-wide, managers with a certain level of authority are fully informed about it. ・The risk-adjusted return and financial soundness are incorporated in the management plan, etc., which are only reported or shared at the board of directors meeting, etc.	・The risk appetite, etc., is disseminated, mainly within related departments, such as the risk management department. ・ERM matters, such as the risk appetite, etc., are not fully incorporated in the management plan, etc.
	ERM organization & system	・ERM covers a wide range of issues, including risk appetite framework, risk profiling, own risk and solvency assessment, stress testing, and risk-adjusted return. Thus, it is important to establish and maintain an appropriate organizational structure for ERM.	・An ERM Committee is established, and roles and responsibilities as to ERM for each department are clearly defined. ・CRO (Chief Risk Officer) leads the ERM system as a whole, in cooperation with the executive officer in charge of planning.	・The Risk Management Committee mainly discusses downside risk management issues, not ERM strategy, due to insufficient involvement of the division in charge of planning.	・There is no established ERM organization, such as an ERM committee.

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Risk Culture & Risk Governance	Development of risk management policies	・Whenever an ERM-related system is developed in accordance with each insurance company’s status, the details of such system should be documented. Documentation of ERM-related rules is fundamental to ERM promotion.	・Rules regarding risks, such as market risk and insurance underwriting risk, are established, and technical documents for internal models are available. Further, each rule is maintained and managed systematically.	・Rules are established for each risk, but no detailed and specific rule (such as technical documents for internal models) is developed. Existing rules are not maintained or managed systematically.	・There are a limited number of rules. For example, rules exist only for major risks.
	Setting, disseminating & entrenching risk appetite framework	・A risk appetite framework is a framework where insurers make decisions based on the risk-adjusted return, thus it is fundamental to their business management. In this connection, the risk appetite, which defines the level of risk to be taken by insurance companies, is the most important element.	・The risk appetite is determined both qualitatively and quantitatively, for which details and underlying principles are disseminated both internally and externally.	・The risk appetite is determined both qualitatively and quantitatively, but details and underlying principles are not disseminated.	・No decision has been made as to the risk appetite. ・Only qualitative risk appetite is defined.
	Audit system	・Issues, such as “whether a system for ERM is established and implemented” and “whether ERM systems are effective”, should be audited and evaluated through internal audit and audit by the board of corporate auditors.	・Internal audit is performed with regard to the ERM system, including internal models. The board of corporate auditors, etc., also conducts audit, taking up ERM issues systematically.	・Internal audit, etc., is conducted in relation to ERM as a whole, but the content and depth of the audit is not considered advanced.	・Internal audit is performed regarding systems for individual risk management, such as underwriting risk, but ERM as a whole is not audited.
Risk Control & Capital Adequacy	Ensuring company-wide (group-wide) financial soundness	・One of the important objectives of ERM is to adequately ensure the financial soundness of insurance companies. Thus, it is important to examine the adequacy of insurers’ overall financial soundness, and the existence of a mechanism to ensure overall financial soundness and a system to monitor such mechanism.	・The frequency of monitoring financial soundness both on the basis of the existing solvency regulation and economic value is satisfactory, and the quality and quantity of capital is managed appropriately. ・Breach of a risk limit set for a monitoring purpose, will trigger the development or execution of an action plan.	・Financial soundness is confirmed both on the basis of the existing solvency regulation and economic value, but the monitoring system is not considered advanced.	・Only the existing regulatory solvency margin ratio is confirmed regularly.

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Risk Control & Capital Adequacy	Ensuring financial soundness for each risk category and business line	・To ensure insurers' financial soundness adequately, it is important to set a risk limit for each risk category and/or business line, develop a monitoring system to check against the limit, and maintain a mechanism to comply with the limit.	・A risk limit is set for each risk category and business line, and a system is in place to trigger the development or execution of an action plan, upon breach of the limit.	・Financial soundness is ensured by comparing the risk taken against the risk limit for each risk category, etc.	・Comparison is made only between the company-wide risk and margin. A risk limit is not set for each risk category.
	Status of stress testing	・Stress testing is an effective tool for ensuring financial soundness and balancing risk and return, in that it involves the examination of the possibility of loss occurrence in excess of the risk recognized by internal models, and should such loss occurrence scenario be probable, it can be used to adjust the existing risk appetite.	・Reverse stress testing, as well as stress testing based on an integrated stress scenario, are performed under an appropriate process, and the test result is fully utilized.	・Reverse stress testing, as well as stress testing based on the integrated stress scenario, are performed, but the results are not utilized fully.	・No reverse stress testing, or stress testing based on the integrated stress scenario, is performed.
Risk Profile & Risk Measurement	Risk identification & analysis, appropriateness of targets	・Comparative analyses by insurers of risks calculated for each risk category and business line is not only useful for capturing their risk profile appropriately, but also an important basis to define their risk appetite.	・The risk amount is perceived for each risk category and business line, and an analysis is conducted on each risk, thereby the risk status is understood appropriately. ・Reference materials sharable among officers, such as risk registers, heat map, etc., are utilized.	・The risk amount is perceived for each risk category and business line, and the financial soundness is confirmed. However, comparative analysis of risks is not conducted.	・The risk amount is not perceived for each risk category or business line.

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Risk Profile & Risk Measurement	Risk quantification and aggregation methodologies	・When implementing ERM, such as decision-making under the risk appetite framework, it is essential to use internal models, and quantify risks comprehensively and appropriately.	・A system exists to comprehensively capture quantifiable risks by using internal models. Risks are aggregated, considering a potential increase in correlations among risks in a stressed situation.	・With some exceptions, most risks are quantified comprehensively through internal models.	・Risks are not quantified on an economic value basis. ・Only some of the risks are quantified by internal models.
	Measures against unquantifiable risks, such as liquidity risk	・Amount of quantifiable risks does not mean identifying all risks facing insurance companies. To make decisions appropriately, it is important to comprehensively identify unquantifiable risks, such as liquidity risk.	・An internal mechanism exists to identify unquantifiable risks comprehensively and appropriately, including liquidity risk.	・While lacking comprehensiveness, risks that are difficult to quantify, are considered and perceived.	・Only limited efforts are made to consider and understand risks that are difficult to quantify.
	Measures against emerging risks	・Emerging risks are risks arising from unusual causes and changes in the external environment, which may seriously impact insurance companies. It is important to manage emerging risks, as they are not controllable based only on events and experiences in the past.	・A process for capturing emerging risks exists, and a wide variety of risk events are listed and policies for evaluating and managing such events are developed.	・A process for capturing emerging risks exists, and a wide variety of risk events are listed. However, the system to manage such risk events is not considered advanced.	・Emerging risks are not included in the scope of risk management.
	Model governance system	・Should insurers make decisions based on a risk amount that does not appropriately reflect the true picture of the risk, they may end up taking the wrong actions. It is important to develop a framework to verify internal models for risk quantification.	・Rules for internal model governance exist, and a framework is established to verify the appropriateness of internal models from an independent point of view.	・Internal models are verified, but not based on established rules for model management. Systematic verification processes are not yet established.	・No verification test is performed as to internal models, except for basic verification tests, such as back-testing.

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Application to Business Management	Confirmation as to mid- to long-term capital adequacy, incorporation of ERM in setting management plans and target ROEs	・Calculation of 3-5 year economic-value-based and regulatory solvency margins is important, as it will contribute to insurers' efforts to improve their financial soundness in the future. ・Further, it is also important to analyze profitability incorporating associated risks, as well as financial soundness, as it will support insurers' efforts for growth and profitability, while maintaining financial soundness.	・Decisions are made reflecting profitability indices calculated incorporating associated risks and solvency margins (both on the basis of the existing regulation and economic value), both simulated over a 3-5 year horizon.	・Solvency margins (both on the basis of the existing regulation and economic value) are simulated over a 3-5 year horizon, but only financial soundness is confirmed.	・The regulatory solvency margin is simulated over a 3-5 year horizon, but only financial soundness is confirmed.
	Implementation of a capital allocation program, etc.	・For insurance groups and companies managing risks for each risk category and business line, a capital allocation program is effective for balancing risk and return and improving their growth potential and profitability, while maintaining financial soundness. Additionally, activities under the program, for example, the development of a capital allocation plan, will promote communication in a group or a company and enhance the group-or company-wide governance .	・Management under a capital allocation program is fully adopted in the organization, in which the amount of capital allocation is adjusted by way of risk-return indices to improve company-wide financial soundness and profitability. ・The capital allocation program is utilized to enhance the group- or company-wide governance.	・A capital allocation program is not fully applied in the management of the group or the company.	・A capital allocation program, etc. is not yet applied.
	Establishment of profitability indices and evaluation of performance thereof	・If insurers do not endeavor to balance risk and profit through the use of risk-return indices, their financial soundness may deteriorate through sales of a large volume of unprofitable insurance products. Therefore, it is important to use risk-return indices and check whether profits are generated appropriately, in light of the amount of risks taken.	・Risk-return indices, such as ROR, and their respective target levels are set to improve both financial soundness and profitability.	・While risk-return indices are set, actions are taken only to the extent of ex-post confirmation, not to the level considered that they are utilized for management.	・Risk-return indices are not set.
	Application to product development, premium rating, business decisions, etc.	・Conducting a risk return analysis for each product and incorporating results in sales strategies and product design will induce appropriate pricing among products with identical risk characteristics, and ultimately contribute to the formation and growth of an appropriate insurance market. Further, the actions above can be utilized for entering into new business and business withdrawal.	・The status of risk-adjusted return is identified for each insurance product and reflected in sales strategies, product design, etc. ・When investing in a new business, the aspect of consistency with the ERM culture is examined, and analyses are conducted in light of risk-adjusted return.	・The risk-adjusted return for each product is confirmed retrospectively, but not to the extent considered utilized for management.	・The risk-adjusted return is not perceived for each insurance product.