



*Pravin Pather, senior underwriter at Centriq Insurance, takes a closer look at the importance of Enterprise Risk Management within insurance companies and discusses the impact thereof on underwriting*

According to global ratings agency, A.M. Best, risk management is paramount to an insurer's long term success, noting that "being adept at risk management practice will not only help to make an insurer compliant to the Solvency Assessment and Management / Solvency II regime, but it will also help the insurer to remain competitive in the current dynamic environment, build sustainable earnings and capital accumulation; and ultimately maintain high ratings, with the attendant benefits relative to accessing capital and credit and an increased reputational and corporate profile."

Full integration of risk management into the insurance business implies that, while senior management is responsible for the risk management system and ensuring that it is used in managing the business, the concept of the risk management must be owned, monitored and managed at a local level. Therefore, each function within the organisation should understand how its decisions affect the risk and capital profile of the firm, especially with regards to underwriting. As one of the five key categories of risks faced by insurers, underwriting risks are fundamental to the insurance business and key to many other functions, such as product design and pricing.

A paper entitled *Refining the Focus of Insurer Enterprise Risk Management Criteria* published by rating services agency *Standard & Poor's* after the agency added a formal evaluation of insurer ERM capabilities to the rating process, rated underwriting as the key risk for non-life insurers. The agency defines underwriting risk as "the risk the coverage offered will have a different risk profile and therefore different loss distribution than is needed to achieve the targeted profit."

In this respect, the lines between enterprise risk management and underwriting risk management are blurred, requiring underwriters and corporate risk managers within an insurance company to work together ever-more closely to ensure that the company's risks are managed and its objectives are met. The insurer's risk appetite, the limits imposed and the reinsurance treaties entered into clearly impact every decision made by the underwriters. Likewise, the decisions made by underwriters directly impact the insurer's risk and its risk management strategies.

Therefore, from an insurer's global risk management perspective, underwriting processes should be broadened to entail:

- identifying holistically all risks including inherent risks under their broad contracts as well as unintended concentrations of risks
- evaluating correlations between risks to monitor and effectively control accumulations
- collecting adequate data for quantifying risk integration and accumulations and measuring diversification; and

- implementing an adequate underwriting infrastructure to measure discipline and manage exposures after reconciling to Alternative Risk Transfer measures that may have been adopted
- effectively optimise and restructure reinsurance programmes to ensure that there are no unintended and inherent risk accumulations and retentions
- to ensure underwriting risk selection limits and types, and product wordings consistently comply with reinsurance treaty programmes
- to ensure compliant administration, including claims settlement that complies with underwriting product wording, practices and local regulations

In addition, the underwriting cycle must be monitored and managed to ensure that optimal underwriting decisions are made in line with current and expected market conditions while the reinsurance programme must be aligned with the overall risk tolerance.

To achieve the above, the overall risk identification and monitoring process must be continuous while feedback to and from underwriters is crucial. It is only with up-to-date and accurate information from the underwriters that corporate insurance risk managers can respond to emerging trends by modifying pricing and underwriting guidelines.

Therefore, a crucial part of the insurer's ERM is continuous interaction and integration with the underwriting department and the tight management of underwriting risk. In this regard, Standard & Poor's suggests that, as a starting point, an insurer should have an underwriting plan, which includes objectives, strategy, and measurable targets, in place. Authority limits for underwriters and referral procedures, including types of risks, exposure limits and terms and conditions allowed, are also recommended.

Having said that, good underwriting starts with consistent, fully documented underwriting standards with clear risk limits and underwriting checklists to maintain standards for the nature and amount of data needed to support an underwriting decision. And it is for this very reason that training is essential to ensure that underwriters understand the global ERM strategy of the insurer, together with the applicable standards and limits, laws, statutes, regulations and other requirements.

A robust compliance enforcement process should ensure clear accountability for the underwriting itself and underwriters should be required to fully document their underwriting decisions to assist future audits. A "four-eyes" principle, whereby each significant risk requires two peer underwriters to approve each risk could also be a useful strategy. Monitoring is crucial to ensure any breaches of limits or authority is addressed swiftly.

In light of these requirements, to ensure full integration of ERM in insurance companies, it can be expected that the ante will be upped significantly in the underwriting department going forward. Underwriters will no longer simply be responsible for understanding and evaluating the risks insurers will assume on behalf of their clients. They will be required to step beyond this role to become a crucial part of the insurer's ERM strategy by understanding, evaluating and managing the underwriting risks faced by the insurer, in close co-operation with the corporate risk managers..