ART GALLERY FOR NOVEMBER

When 1 plus 1 equals more than 2

By Dick Goff

We'll tee up this visit to the Gallery by recalling a couple of recent columns that may offer synergistic benefits to captive owners – synergistic, in this usage, meaning a combination greater than the sum of its parts. Purely accidental on my part, you may be assured.

In the July issue we introduced the concept of enterprise risk management (ERM) that is a process incorporating all the usual mitigation tactics but also extending to the broader range of risks that may be introduced by the government, business circumstances, natural disasters or other untoward circumstances affecting the enterprise.

Then last month we reported that some members of the National Association of Insurance Commissioners (NAIC) are in favor of requiring captives to be added to the NAIC's Own Risk and Solvency Assessment (ORSA) self-reporting process that will embrace commercial insurance companies beginning in 2015.

It struck me that ERM could be an effective springboard for captives to analyze and report their condition if the NAIC includes them in the ORSA process. For a response to that notion I dialed up Mary Peter, director of enterprise risk management for CPA/consultant firm Eide Bailly LLP in Minneapolis. I had noticed that Mary would moderate a panel on the ORSA reporting process at the Insurance Industry Forum: ORSA next month in Boston (www.InsuranceIndustryForum.com).

My first question to Mary centered on whether being required to make an ORSA report to their lead state commissioner wouldn't be an inordinate burden on captives.

"It's an inordinate burden for all insurance companies," she responded, citing the NAIC ORSA Guidance Manual that is confounding insurance companies by its breadth of scope. She agreed that the ERM process could help companies deal with such an arduous self-reporting process as they include ordinarily considered risks along with extraordinary risks that could damage companies' reputations or relationships with stakeholders.

In counseling companies on the ERM concept and designing an effective ERM process, Mary described a planning process that involves setting up cross-functional teams that often include managers of finance, governance, compliance, IT, operations and risk management. “Often we see teams formed whose members haven’t previously worked together and don’t always know what each other does,” Mary said.

I observed that such groups would need an interpreter just to talk to each other because the languages of various functions can be arcane. “That’s why they need someone like me to help them facilitate,” she said. “But usually it doesn’t take too long until you reach the ‘ah-ha’ moment when people begin to understand how ERM can be a valuable skill to develop.”

In a diagram Mary offers, ERM is seen as an umbrella function over the usual functions of governance, risk management and compliance (GRC). “ERM is an archway for the company to take a holistic approach,” she says. “By clearly defining your ERM framework and then bringing in GRC components, the risks and opportunities relating to the company’s strategic vision become clear. Now the company is able to look at the interdependency of risks and their outcomes to the whole organization.”

She cites often overlooked and seemingly intangible risks that ERM can expose. “Consider the risk of a failure of equipment creating an oil spill in public waters. An assessment of this risk would typically involve looking at fines, penalties, cleanup costs and profit loss. The missing elements in this scenario are the intangible assets or those which are difficult to quantify – for example, the future costs including legal fees, regulatory investigation, government involvement, public relations, media cost and reputation damage.”

She says that such an exercise can identify a more accurate risk of capital and a more effective enterprise-wide approach to managing the company’s assets – both tangible and intangible.

I couldn’t help but wonder if BP had taken such an approach to prepare for the contingency of an oil spill in the Gulf of Mexico.

Mary finds some ray of light in the NAIC’s ORSA process: “The biggest benefit is that the ORSA report is authored by the company – here’s who we are, what we do and how it works in our industry and as it relates to our complexity – rather than being assessed by the regulator or another entity that may not have a good understanding of your particular products, company and industry."

My thought was that the better prepared a captive can be through the ERM process, the better it would be able to handle ORSA if it becomes necessary.

"Exactly," Mary agreed. "You would have a framework to build on to help meet an ORSA Model Act, and at the very least would produce better reports for the usual regulatory review."

Readers are invited to send their questions or comments to the ART Gallery or, if moved to cover a subject in depth, send a query describing your article to managing editor Gretchen Grote at ggrote@sipconline.net.

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