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Emerging risks survey reveals "post-crisis" thinking

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This year's poll of North American risk managers shows a shift in concern away from the economic crisis and towards issues such as regulatory change and cyber risk. Christopher Cundy speaks to its author, Max Rudolph

Five years on from the financial crisis that forced governments to choose which financial institutions were "too big to fail", the alarm among risk managers about economic risks is diminishing.

So says the annual Emerging Risks Survey, a poll of more than 200 risk managers predominantly based at North American re/insurance companies.

Now in its seventh year, the survey - sponsored by the Canadian Institute of Actuaries, the Casualty Actuarial Society and the Society of Actuaries - reveals how risk managers are now more likely to be concerned about cyber risks or demographic changes. It also shows how enterprise risk management (ERM) in general is growing in influence at insurers.

Max Rudolph, a risk consultant who prepared the 2014 report, tells *InsuranceERM*, "Two years ago, people were expecting the second coming of 2008. Now, they tend to be looking at a longer time horizon."

Max Rudolph

Top risks

Economic factors still led the emerging risks identified in the survey, and when respondents were asked to name the single emerging risk with the greatest impact, financial volatility led the table (see below).

Top five emerging risks

1. Financial volatility (24% of respondents)
2. Cyber security/interconnectedness of infrastructure (14%)
3. Liability regimes/regulatory framework (10%)

4. Blow up in asset prices (8%)
5. Chinese economic hard landing (6%)

But financial volatility was one of the biggest fallers of the year, alongside risks such as an oil price shock and the proliferation of weapons of mass destruction.

In contrast, new highs were recorded for severe weather, regulatory frameworks and cyber security/ interconnectedness of infrastructure.

Anchor bias

The report openly acknowledges the issue of anchoring - the human trait that in this context means that responses to questions about emerging risks are influenced by recent events.

In Rudolph's words, "Each survey has been conducted in periods with unique characteristics that drove results. The perceived risks of environmental, societal and technological risks are rising, while risk managers are moving away from a focus on economic and geopolitical risks as conditions stabilise."

For instance, he tells *InsuranceERM* that geopolitical risks probably would have ranked higher had the poll been conducted today rather than in October 2013, since the Russian invasion of Crimea has drastically heightened geopolitical fears.

However, the polling does try to minimise anchor bias by reminding respondents of its effect before they are questioned.

Cyber risk

To see cyber security/interconnectedness ranked is perhaps no surprise then, given the amount of media coverage it has had recently. But the risk was flagged up in 2009, when 21% of respondents had it in their top five emerging risks, and it has risen steadily to feature in 47% of top fives this year.

"We have seen a nice trend on cyber. Half of respondents are now listing it in their top five," Rudolph says.

He argues that the rise of cyber risk is also part of a trend towards thinking about longer-term issues, and away from the short-term focus on survival that characterised thinking in the aftermath of the financial crisis.

"Cyber risk is exactly like that - there's going to be exposure for 10 to 20 years. It could be the next asbestos, or it could be sorted out pretty quickly," he says.

Regulations

After the crisis, most governments reacted strongly to perceived failings in their supervisory regimes with a raft of new rules, which goes part-way to explain why regulatory change is such a riser.

Rudolph's reasoning is more nuanced. "People are really worried about regulations. Not about the specific regulations, which they see the value in, but that they are changing so much."

Too-rapid changes in rules combined with limited internal resources mean that risk managers must drop their core activity - improving insurers' internal risk management - to allow time to comply with new rules.

ERM adding value

Alongside the survey of emerging risks, risk managers are also asked a number of questions about ERM in general.

Three quarters of respondents see ERM activity rising but, rather depressingly for them, only half expect funding to rise.

For the first time, the report posed the question: do ERM efforts lead to improved risk/return ratios (see chart, below.) The results were fairly emphatic, but a not-insignificant 19% disagreed.

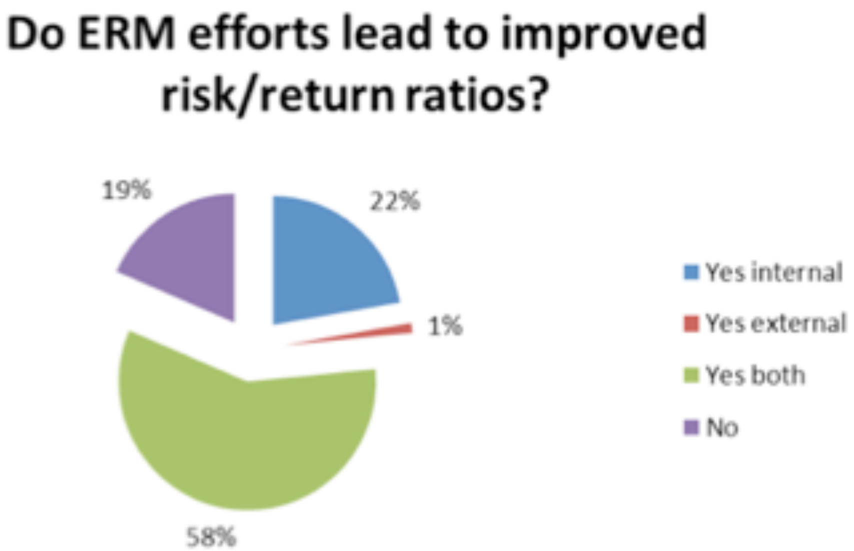

Chart 1: Do ERM efforts lead to improved risk/return ratios?

Rudolph puts the negatives down to particular cultures at insurers where, for example, senior managers have not grasped the message on ERM and regard it as a cost centre and a "necessary evil."

Perhaps more damning is the view on whether managing emerging risks was worthwhile, where only 28% could say for certain that it has a positive effect on the firm (see chart, below.)

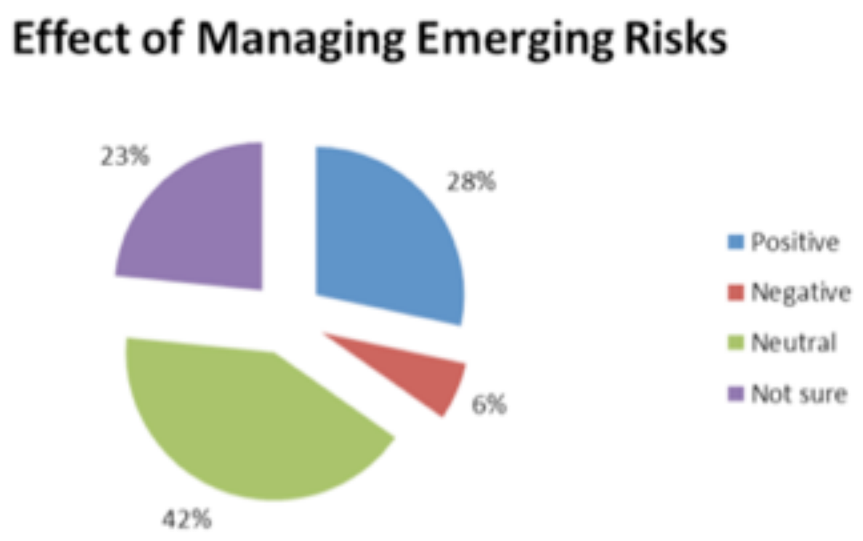

Chart 2: Effect of managing emerging risks

Opinion suffers partly because of the time horizons involved with emerging risks, so it is hard to quantify the benefits. Also, because of the complexity of the issues and the immaturity of research on the topic, there are no clear-cut logical methodologies.

Using the results

Is there any practical use for the study beyond intellectual curiosity? Watching the recurring trends is valuable, Rudolph says, and risk managers can obviously benchmark their emerging risks against the general market opinion.

But they should also seek out the qualitative aspects that emerge from the survey, he says.

The full report includes a "data dump" of comments from respondents and looking through these can help risk managers think about issues they may not have considered before.

For example, in one of the early surveys, one commentator wrote a lengthy passage about how China's economy was going to overheat and run into trouble. At that time it was a lone voice, but other risk managers were alerted to the forecast - and it was borne out by subsequent events.

Combining qualitative with quantitative analysis can produce a rich vein of insights. Edging too far towards the quantitative is sometimes pointless - as one respondent to this year's survey said, "Understanding what can happen and how to address the risk is more important than specifying the exact impact of a potential event."

As another commentator surmised, "I truly believe a quantitative approach driven by qualitative guidance is a superior approach to risk management!"

- The full report is available for download as well as a summary of findings