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Practical - Emerging Risk

Emerging risk relates to two distinct domains of risk management.

- The first concerns the evolution of known exposures for example, whiplash, pneumoconiosis and vibration diseases. These have a history which can be understood and used to project exposure for the coming year/years.
- The second concerns exposures, which may be retrospective, which have not yet manifest in claims and may not ever do so. There is no claims history.

Clearly, the second group includes issues which will evolve into the first. If this happens slowly enough, and assuming there is no competition in the market, the first is the only understanding that is required.

In both domains most such changes are too small to concern business strategists. This leads to two practical definitions:

Emerging risk: 2 views.

- NEW.
- Changes in exposure which cannot now be predicted precisely enough by actuarial projection.
  - Magnitude and or uncertainty
- KNOWN.
- The probability of exceeding a defined action threshold is increasing.
  - Magnitude and or uncertainty

For new risks, the actual and the forecast exposures may well be very different. Best estimate of loss may seem to be below the action threshold, but uncertainty means it could be well above. In this situation the business manager decides how uncertain the estimate must be before he takes the issue to the next level of scrutiny.

For known risks, the precision should be much higher, but events can cause near term change that was not anticipated. In case this happens, the business manager decides an action threshold and the specific issue manager estimates when/if that threshold will be in range. Advance notice of threshold breach can be provided. Planning time is available.

Both understandings of emerging risk then have much the same requirements: Loss and uncertainty must both be estimated, rate of change is important to both. The difference is a) in the methods

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used to make those estimates and b) in which part of the risk management cycle the information is targeted.

So how do you manage these exposure and uncertainty estimation needs?

One approach is simply to accept change. In this case retroactive management will either work or shareholders will risk disappointment. If the cost of making such estimates is too high then it simply won't be done, even if it could be done.

Risk management follows from having defined the problem in a way that fits in with business decision-making.

Deterministic Process

- Monetise additional potential losses and their uncertainties. Portfolio? Impenetrable.
- Sensitivity analysis. Key variables. Thresholds.
- Decision. Customer-facing. Internal.
- What would need to change…
  - To exceed threshold, tolerance, appetite?
  - To change your opinion?
- Regular updates to narrative and facts.

The key step, besides good management, is the question:

> What would need to change to exceed threshold, tolerance, appetite and, to change the opinion of the decision-maker?

The more precise the decision-maker can be in specifying this trigger, the more his team will be able to interrogate the exposure mechanism, identify trend and advise.

Whenever an emerging risk decision is taken, the experts who made that decision should be asked to state what would need to change to change their minds. Not only does this empower the team to focus on the key areas, it enables the decision-maker to accept the change and adopt a new course.

It also means that the expert decision-makers are not constantly re-evaluating when a news story comes up or when a minor change is detected.

This approach to emerging risk is systematic, transparent, responsive and auditable, yet, fully trusts in the judgment of business experts.