

Abstract **Risk Management Quantification**

Topical Areas: Quantitative vs. Qualitative Analysis of Risks

Synopsis of article

Main Theme: This abstract provides a brief overview of *Aon's Risk Management Quantification* issued in February 2006.

The majority of the focus on Enterprise Risk Management has revolved around qualitative versus quantitative aspects. However, quantification of enterprise risks may allow a firm to benefit from an actuarial perspective. Three widely used frameworks throughout the world are listed below that blend common subjects such as risk classification, prioritization, and quantification but vary in region and industry.

- COSO's Enterprise Risk Management — Integrated Framework
- Basel II's International Convergence of Capital Measurement and Capital Standards: A Revised Framework
- Australian/New Zealand Standard: Risk Management

Given the current focus on qualitative aspects by the frameworks listed above, an opportunity clearly exists to develop a more thorough quantitative framework through the use of actuarial and mathematical models.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is evolving with the anticipation that others (e.g. Casualty Actuarial Society) will be challenged to rethink the ERM framework. The guiding principals of the COSO ERM framework hinges on the premise that entities exist to provide value for their stakeholders. Also, enterprise risk management allows management to take advantage of the opportunities in risk while managing potential pitfalls that would adversely affect an organization's value.

A six step process is used to shape the ERM framework:

- define risks,
- design risk models,
- identify relevant industry data and set parameters,
- test risk models,
- utilize results from risk model and explore risk appetite alternatives,
- monitor risk process continually.

In the end, one should remember that models are not infallible and are only intended to be a guide for users. Models are never developed to replace the decision-making process that is always crucial.

Source: "Enterprise Risk Management Quantification – An Opportunity," by Christopher (Kip) Bohn, ACAS, MAAA and Brian Kemp, FCAS, MAAA, Aon Corporation, Chicago, IL, (February 2006).

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