



Enterprise Risk Management for Microinsurance Mutual Benefit Associations





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for Microinsurance
Mutual Benefit Associations**



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Microinsurance Mutual Benefit Associations
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For information and other concerns with regards to this publication, please get in touch with the RIMANSI Secretariat or visit their website <https://rimansi.org>.

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INTRODUCTION

Microinsurance Mutual Benefit Associations (Mi-MBAs) are unique to the Philippine setting. Being client owned and managed organizations, they have proven to be effective vehicles in making available appropriate risk protection to those who cannot afford the traditional form of insurance. Over the last decade, Mi-MBAs have grown to become the dominant institutions driving the growth of the microinsurance industry.

Mi-MBAs are in the business of managing risks. However, the concept of Enterprise Risk Management (ERM) relatively remains unknown to them. This document intends to provide Mi-MBAs with an appreciation of ERM. It aims to help them develop their own framework suited to the context of their organization. The intention of this document is not to prescribe a specific approach but rather to act as guide in starting their ERM journey.

The ERM principles, framework and process discussed in this guide are largely based on the ISO 3100 standards and to the Committee of Sponsoring Organizations (COSO) framework. Concepts have been integrated and simplified to suit Mi-MBA beginners.

This guide will attempt to answer the following questions:

- Why?
 - Why do MBAs need to apply ERM?

- What?
 - What is ERM? The principles, the framework and the process?

- How?
 - How can MBAs apply the ERM framework and process in their organization? What tools can they use?

WHAT IS THE DEFINITION OF A RISK?

A risk can be defined in many ways. For the purpose of this guide, risk is defined as:

“The possibility that an event may occur and affect the achievement of objectives”.

There are 3 main elements in the risk definition (Figure 1). These are:

1. ***What can happen?*** - An **event** of something happening.
2. ***Will it happen?*** - The **probability** or likelihood that it will happen.
3. ***What is the effect should it happen?*** - The **consequence** or impact of the event, should it occur.

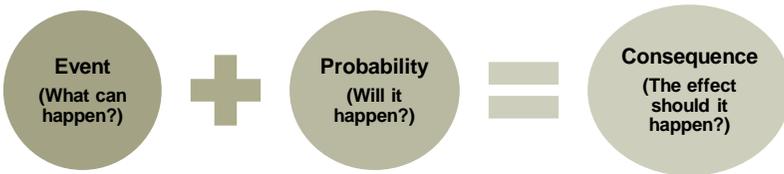


Figure 1: Elements of Risks

To better understand the impact of an event, it is essential to link risks to organizational objectives. Therefore, it is a condition that Mi-MBAs must have explicitly stated as strategic objectives to identify the relevant risks they face.

Risks can be classified as either negative (*diminishing the achievement of objectives*) or positive (*enhancing the Mi-MBAs' achievement of objectives*).

WHAT IS ENTERPRISE RISK MANAGEMENT?

There are many definitions of ERM. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines ERM as: *“A process effected by the Board, management and other personnel, applied in strategy setting and across the enterprise designed to identify potential events that may affect the entity and manage risk to be within its risk appetite to provide assurance regarding the achievement of the entity objectives.”*

A simpler definition of ERM is:

“A rigorous approach to assessing and addressing the risks from all sources that threaten the achievement of an organization’s strategic objectives.”

Both definitions of ERM have common elements among which are:

- a. It is a process or approach;
- b. It is enterprise wide (applied across the organization)
- c. It identifies, assesses and manages potential risks
- d. It is focused on ensuring that strategic objectives are achieved.

HOW DOES ERM DIFFER FROM TRADITIONAL RISK MANAGEMENT?

As insurers, Mi-MBAs are in the business of risk management. In most cases, the risk management practiced remains traditional or reactive in nature. It waits for the risk to happen and is often compartmentalized in individual units (referred to as a silo approach). The unit heads are often left to deal with their particular risks with no person in the entire organization having a clear understanding of the overall organization’s risk exposure.

On the other hand, ERM is a proactive approach. It anticipates risks before it occurs with the responsibility of risk management elevated to top management. It provides organizations with an integrated and holistic view in managing risks and promotes a risk culture where all staff are aware and responsible for reporting and managing risks.

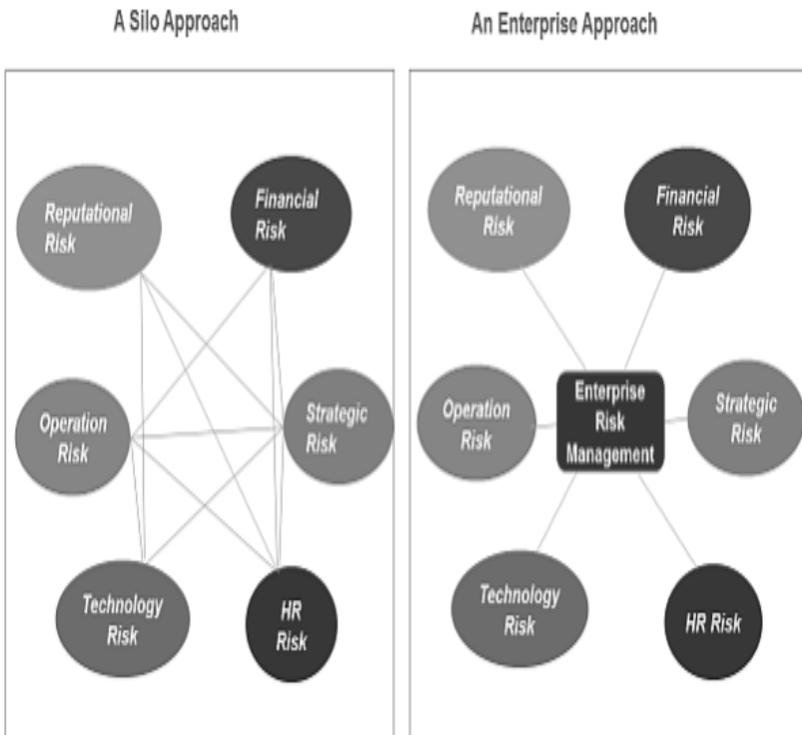


Figure 2: Silo versus an Enterprise Approach

WHY ENTERPRISE RISK MANAGEMENT?

ERM starts with the basic assumption that the aim of all organizations, whether non-profit or for profit, is to create “value” to its stakeholders. The measures of “value” can either be tangible or intangible. Tangible measures include the quality, quantity and

coverage of microinsurance services; sustainability, capital adequacy, liquidity and other financial metrics. Intangible measures include the credibility and reputation of the Mi-MBA. “Value”, the most important to the organization, is often stated in its strategic objectives.

In seeking “value”, Mi-MBAs are faced with many uncertainties in its environment. As underwriters, they will need to take into account the increasing frequency and severity of natural and man-made calamities. As investors, they have to deal with the uncertainty of the economic conditions and as a legal body, they have to conform to the constantly evolving regulatory requirements. These uncertainties present potential risks that can affect the ability of Mi-MBAs to achieve the desired value creation objective it wishes to achieve.

There are three (3) fundamental reasons why Mi-MBAs need to embrace ERM. These are as follows:

1. **Sustainability** – ERM helps management make better quality decisions to positively influence the long-term viability of the Mi-MBA.
2. **Compliance** – ERM helps management to comply with and anticipate reporting requirements from government and self-regulatory bodies. Many countries have started to require comprehensive risk management reporting from insurers due to the uncertainties in the environment. There is a possibility that such reports may soon be required from Mi-MBAs by regulatory bodies in the Philippines.
3. **Favorable Credit Rating** – ERM helps management to maintain favorable credit ratings (should there be any) which will impact on the ability to access capital at lower interest rates. Rating agencies in other countries have already included an evaluation of the robustness of an

insurers risk management programs as part of their ranking system.

WHAT ARE THE BENEFITS OF ERM?

Three (3) key benefits are commonly mentioned by current practitioners of ERM. These are:

1. **Less surprises.** ERM works like an early warning system and anticipates potential events that may occur and impact the Mi-MBA in the future. ERM systematically identifies and manages these potential risky events to avoid surprises that may cause extensive losses to the association.
2. **Less mistakes.** ERM makes Mi-MBAs more operationally resilient. It ensures that key risks are understood where mitigating measures are prepared for potential catastrophic failure. It helps align objectives with stakeholder requirements and helps improve resource allocation to areas needing more attention.
3. **Less missed opportunities.** ERM helps identify and respond to both negative (threats) and positive risks (opportunities). It does not only provide a platform to minimize vulnerabilities but also aids in making the most of the potential opportunities that presents itself to the Mi-MBA.

DEVELOPING AN ERM PROGRAM: THE HOW?

KEY COMPONENTS OF ERM

Under the ISO 31000 ERM standard, there are three key components in developing an ERM program. These are: 1. The ERM principles, 2. the ERM framework and 3. the ERM process (Figure 3).

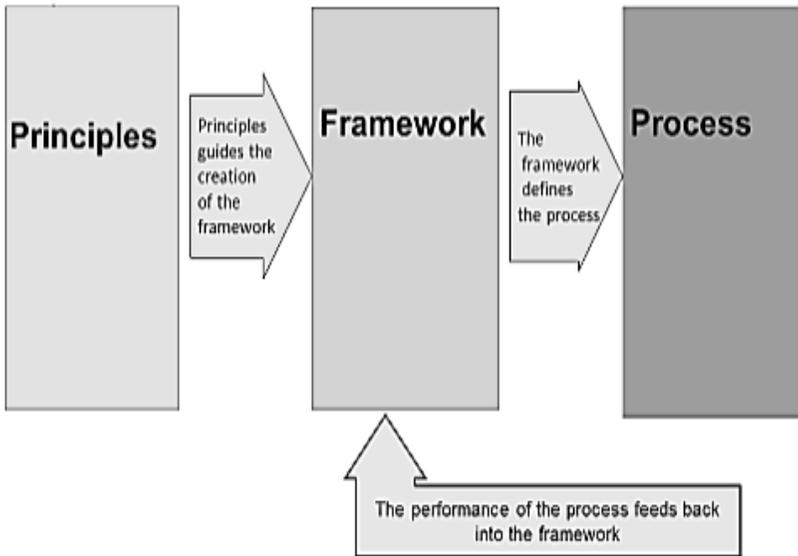


Figure 3: Components of ERM

1. The **ERM principles** provide the foundation for risk management. It describes the essential qualities to effectively manage risks in an organization.
2. The **ERM framework** provides the overall governance including risk policies, roles and accountabilities, process and integration into the organization's planning, implementing and review systems.
3. The **ERM process** provide the methods and system for risks identification, analysis, evaluation, and treatment.

The set of ERM principles acts as a guide in developing the ERM framework. The framework in the same way, defines and guides the ERM process. A mechanism for feedback is provided between the

ERM framework and ERM process to allow for continuous review and improvement of the overall ERM program.

ERM PRINCIPLES

ERM principles provide the foundation for effective risk management of an organization. There are eleven (11) basic principles set forth by the ISO 31000 standard for an effective ERM program. These basic principles are enumerated below:

Risk management should create value	Risk management should contribute to the achievement of objectives. It should help improve performance, efficiency of operations, governance, and regulatory compliance.
Risk management should be an integral part of organizational processes	Risk management is not a stand-alone activity. It is a key responsibility of management and integrated in strategy development, planning, implementation and assessment processes. It is neither an additional task to comply with.
Risk management should be part of decision making	Risk management should help decision makers differentiate among alternative courses of action, make informed choices, and prioritize actions to take. It helps management decide how to allocate the scarce resources.
Risk management explicitly addresses uncertainty	Risk management takes into account uncertainty, the nature of that uncertainty, and how it can be addressed.
Risk management should be systematic and structured	Risk management should be a methodical approach. It should contribute to consistent, comparable and reliable results. It should be aligned to the existing organizational systems and structure to make it efficient and effective.
Risk management should be based on	Risk management should collect and use information from a variety of available sources

the best available information	including historical information, experience, observation, forecasts and expert judgment.
Risk management should be “tailor fit” to the organization	Risk management should be aligned with the organization’s internal and external environment. It should consider the type and size of the organization, its strategy, its systems and processes among others.
Risk management should take into account human factors.	Risk management should recognize that every organization is different. It will have its own culture, capabilities, perceptions and intentions of people distinct from other organizations.
Risk management should be transparent and inclusive.	Risk management should involve the participation of key staff at all levels of the organization to ensure that risk management remains relevant and updated.
Risk management should be dynamic, iterative and responsive to change.	Risk management should be a continuous and repetitive process to respond to a changing environment. Existing risks should be monitored and reviewed and new risks identified as soon as they emerge.
Risk management should be capable of continual improvement and enhancement	Risk management should be able to continually evolve and improve as the organization becomes more knowledgeable and skillful in implementing risk management.

The abovementioned principles can adopt to all of the above or otherwise select those that best its organizational context.

THE ERM FRAMEWORK

The ERM framework provides the overall risk governance for the Mi-MBA. This includes the description of risk policies, responsibilities,

accountabilities, processes and mechanisms. As mentioned earlier, The ERM principles serve as the building blocks in developing the framework. (Figure 4).

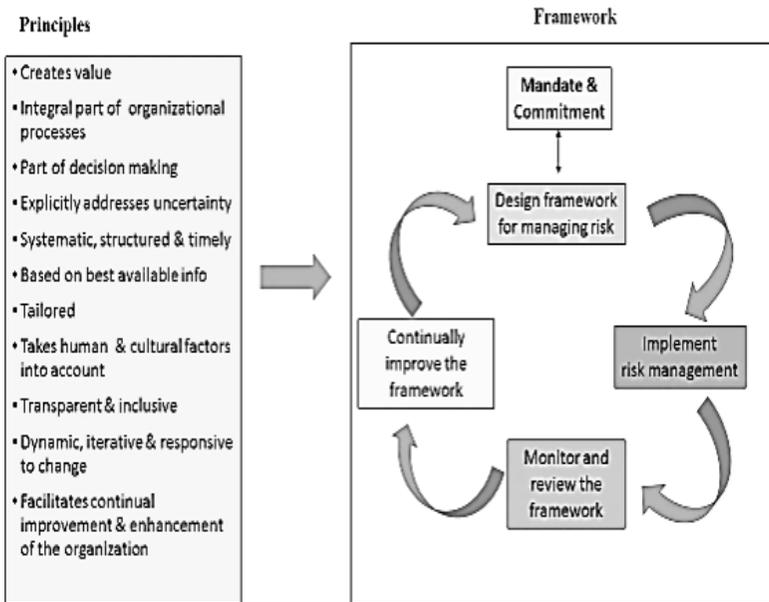


Figure 4: The ERM Framework (ISO 31000)

Before proceeding with developing an ERM framework, it is important to first secure the support of the Board of Directors and management. Without a clear commitment and mandate from top management and the board, any attempt to develop and implement ERM will most likely fail.

It is essential that the ERM framework is designed as a continuous cycle of planning, implementing, monitoring and improvement. This is important to ensure that the framework remains appropriate and relevant as the Mi-MBAs internal and external environment changes over time.

Internal and external factors influence the development of the ERM framework. Internal factors include the size of the Mi-MBA, organizational culture, structure, resources available, capabilities and competencies. External factors include pressure from stakeholders, legislators and regulators who want to ensure that policyholders are protected from unnecessary risks.

Risk Culture

Risk culture exerts a huge influence in developing an ERM framework. It is a subset of the overall organizational culture and represents the collective values, behavior and practices of the organization. Among Mi-MBAs, risk culture is often shaped by the values of the “key founders” who have stamped their own values on the organization. The prevailing risk culture of a Mi-MBA can be judged by past management decisions/actions, existing rules and regulations and ethical standards required of its employees.

Management integrity is a prerequisite for the ethical behavior and ultimately the effectiveness of the ERM.

Risk Appetite

Risk appetite is an important part of risk culture. It is defined as “the extent of risk an organization is willing to expose its assets in pursuing its strategic objectives.” It helps decision makers at all levels recognize what risks or uncertainty the organization is willing to accept and what is expected of them when they have to make choices. There are varying risk appetite philosophies as described in Table 1:

Table 1: Risk Appetite Philosophy

Appetite Level	Risk Appetite Philosophy	Definition	Tolerance for Uncertainty
1	Averse	Not willing to accept risk. Will always choose the lowest risk options In most situations.	Extremely low
2	Conservative	Willing to accept risks in certain situations. Will only accept risks if the possibility of failure is low and the benefits heavily outweigh the risks.	Low
3	Moderate	Willing to accept some risks but will make sure impact is managed.	Some
4	Aggressive	Willing to pursue opportunities having high risks. Will consider options with the highest return and accept the possibility of failure.	Anticipated

Risk appetite can be expressed in qualitative as well as quantitative terms. Some examples are shown in Table 2:

Table 2: Qualitative and Quantitative Description of Risk Appetite

Qualitative Risk Appetite Statement	Quantitative Risk Appetite Statement
Maintaining a risk profile appropriate to our available capital.	Managing risk to earn a 12 percent or greater compound annual return on average capital over a five-year period.
Accepting a “low” level of reinsurance risk, counterparty credit risk, liquidity risk, and foreign currency risk.	Limiting net exposure to loss from a single catastrophic event to 5 percent of available capital.
Limiting investment activities to publicly traded securities that meet minimum size and trading requirements.	No more than 10 percent of the fixed income portfolio may be held in fixed income instruments.

It is possible that risk appetite will vary. It may have a low appetite (conservative) in one aspect but may have a high appetite (aggressive) in another. An example of varying risk appetites using qualitative description (low, medium, high) is shown in table 3.

Risk Appetite Table

	Willingness to Accept Risk				
	Low		Medium		High
	1	2	3	4	5
Earnings volatility					
Capital requirements					
Reputation					
Credit Rating					
Regulatory Standing					

Risk appetite must be within the Mi-MBAs risk capacity. The risk capacity is the maximum amount of risk the Mi-MBA can absorb. If the risk capacity is exceeded, the organization will most likely collapse.

ERM FRAMEWORK COMPONENTS

The risk management policy, organizational arrangement and the risk process are essential components of an ERM framework include the (Figure 5).



Figure 5: ERM Framework Components

THE RISK MANAGEMENT POLICY

The risk management policy includes:

- a. A brief description of the internal and external environment of the Mi-MBA leading to the rationale for adopting ERM.
- b. A clear message from the Board of Directors indicating their full support and commitment for ERM.
- c. The ERM policy objective describing what ERM seeks to achieve.
- d. A statement of the risk appetite statement of the Mi-MBA. The description can be general and qualitative becoming more precise as the Mi-MBA gain more experience in implementing ERM.
- e. A statement about how ERM integrates overall management.
- f. The key ERM principles the Mi-MBA abide by.

ERM ORGANIZATIONAL ARRANGEMENT

The organizational arrangement identifies the key people within the Mi-MBA involved in ERM and their roles and responsibilities. It also makes the relationship between units clear. A sample description of the roles and responsibilities are described below:

1. The CEO/Board of Directors

- a. Oversees the company's risk management programs, procedures and controls.
- b. Approves the risk management framework.
- c. Approves and articulates the risk appetite for the organization; principles and policies recommended by management.
- d. Reviews risk reports.
- e. Monitor risk indicators for identified significant risks.

2. Audit Committee

- a. Oversees the Mi-MBAs financial reporting process and the system of internal control.
- b. Review reports, opinions and recommendations prepared by the appointed actuary with respect to the adequacy of reserving and reporting practices.
- c. Discusses with management, the independent auditor and the appointed actuary matters such as:
 - (a) key areas of risk for material misstatement of financial statements;
 - (b) reasonableness of accounting estimates;
 - (c) significant or unusual transactions; and
 - (f) contentious matters noted during the audit.

3. Management

- a. Develop and implement an effective ERM framework, principles and policies.
- b. Continuously improve the ERM framework.
- c. Determine the risk for the organization.
- d. Establish the risk management structure.
- e. Build a risks aware culture.
- f. Assign responsibilities for risk ownership, monitoring and reporting.
- g. Establish internal and external communication and reporting mechanisms.
- h. Takes action, monitors to ensure risks responses are effective and continuous.
- i. Present periodic risk report to the Board.

4. Unit Heads

- a. Build risk aware culture within their unit.
- b. Agree on unit's risk management performance targets.

- c. Ensure implementation of risk improvement recommendations.
- d. Identify and report changes to situation and risks.

5. Compliance Officer

- a. Develop the risk management policy and keep it up to date
- b. Document the internal risk policies and structures
- c. Co-ordinate the risk management (and internal control) activities
- d. Compile risk information and prepare reports for the Board
- e. Report on the efficiency and effectiveness of internal controls

6. Individual employees

- a. Understand, accept and implement the ERM processes
- b. Report inefficient, unnecessary or unworkable controls
- c. Report loss events

THE ERM PROCESS

The ERM framework includes a description of the risk management process of identifying, prioritizing, treating and monitoring of risks. It also includes the techniques and methods to be used in assessing and evaluating risks.

THE ERM PROCESS IMPLEMENTATION

The ERM framework provides the basis for the ERM process implementation. The process follows the following steps as shown in Figure 6:

1. Set strategy and objectives
2. Identify risks
3. Assess risks
4. Treat risks
5. Control risks
6. Communicate and monitor risks



Figure 6: The ERM Process

The ERM is a continuous process that naturally allow for the constant identification and management of emerging risks and the continuing improvement of the overall risk framework.

Step 1: Set Strategy and Objectives

The first step in the ERM process is to set clear organizational strategies and measurable objectives.

One of the immediate benefits from implementing ERM is the realization that a Mi-MBA may not have an articulated strategy nor measurable organizational objectives. Defining the strategy and objectives is fundamental before moving to the next step. The strategy will provide the direction in developing operational plans and allocation of resources.

Strategic objectives are aligned to the acceptable risk appetite to make sure that organization is not accepting too much nor too little risk.

Step 2: Identify Risks

The second step in the ERM process is risk identification. The objective is to come up with a list of all possible risks that may affect the achievement of objectives and narrow them down to the most significant risks. An inventory of risks, which can be referred to as a risk register, is maintained to keep a list of all possible risks. This risk inventory is reviewed and updated in succeeding risk identification processes taking into account the predicted changes in the internal and external environment. Mi-MBAs undergo this step periodically or whenever new significant events are foreseen.

To identify potential risks, Mi-MBAs can use the following techniques:

- a. Internal interviews and discussions - individual interviews, questionnaires, facilitated workshops, brainstorming and SWOT analysis.
- b. External sources - comparison with other Mi-MBAs, discussion with peers and benchmarking.

It is important to choose a technique that encourages openness among the participants. A combination of techniques may be considered to allow for the identification of as many risks as possible.

Risk Statement

When identifying risks, it is preferred to use a standard sentence to describe the risks. A proposed approach to structure the sentence is as follows: “The possibility (*describe potential occurrence or circumstance*) will impact on (*describe specific business objective set by the organization*). By stating risks in this manner, the elements of risk (the event, the probability and the impact) are covered. An example of applying the risk sentence structure is as follows:

“The **possibility** that a **change in the government tax regulations** for Mi-MBAs will **impact sustainability**”.

Clear risk identification is important because it allows for a more precise assessment of the severity of the risks. It helps identify root causes and the impact of the risk to the objectives of the Mi-MBA. Risks identified can be tabulated in an inventory worksheet similar to the Table 4 below:

Table 3: Sample Risk Inventory Worksheet

Risk Statement (the event)	Strategic objective affected	Unit objective affected (if applicable)	Risk Owner (responsible person)
The possibility of an increase in government tax on Mi-MBAs	Profitability - decrease in ROA		General Manager
The possibility of the entry of	Membership growth - %		General Manager

Risk Statement (the event)	Strategic objective affected	Unit objective affected (if applicable)	Risk Owner (responsible person)
microinsurance competitors	decrease in policyholders		
The possibility of inflation	Profitability – decrease in ROA		General Manager

The risks listed in the inventory worksheet is what is called as inherent risks. Once mitigation actions are determined, what remains are residual risks.

Surveys, workshops or interviews or a combination of all, are methods that can be used to gather input. The size and complexity of the Mi-MBA will influence the method of gathering data.

Risk Categories

There are many ways of categorizing risk. An example of risk categories common among insurance companies is shown in Table 5 below.

Table 4: Sample Risk Categories and Definition

Risk Category	Definition	Risks Included
Credit Risks	Risk of financial loss as a result of default or failure of counterparts to meet their obligations.	Reinsurance risks, lending risks and bank deposit risks.
Market risks	Risk of loss from factors related to the financial market that affects the value of assets.	Interest rate deviations, currency fluctuations, devaluation of equity investments,

ERM for Mi-MBAs

Risk Category	Definition	Risks Included
		fluctuations in real estate and property investment and inflation.
Operational risks	Risks of loss from inadequate or failed internal systems, processes and procedures	Employee actions such as Fraud
Insurance risks	Risks of loss related to underwriting and claims management that affect insurance operations.	Higher than expected mortality rate; higher than expected health and disability claims; non-renewal of policies; inadequate reserves; catastrophic events.
Liquidity Risks	Risks of the inability to generate sufficient cash resources or liquidate assets fast enough to meet financial obligation as they become due.	
Reputational risks	Risk of loss caused by a decline in the organization's reputation (character, quality or integrity).	Deterioration of image and relationship with clients, partner agent, regulators or with the community where it operates.

A simpler way of classifying risks is shown in table 5 below:

Table 5: Simple Risk Classification

Risk Category	Definition
Internal risks	Risks that can be controlled or prevented by a Mi-MBA (e.g. the risk of employee misconduct). This type of risk can often be effectively managed through compliance with established rules or policies.
Strategic risks	Risks taken on (decided) by a Mi-MBA in pursuit of value (e.g. the risk associated with pursuing a high expected return). Strategy risks are different from preventable risks because they are not inherently undesirable. Strategy risks will need a risk management system. It cannot be managed through a rules-based control mechanism.
External risks	Risks beyond the influence or control of the Mi-MBA (e.g. the risk of impact from a natural catastrophe, political disaster). External risk will need a different approach. Although there might be a lack of control over this type of risks, Mi-MBAs can still manage these risks by developing plans to mitigate the negative impact should the event actually occur in the future.

There are many other ways of categorizing risks. It is important that each Mi-MBA find out the most practical way to classify their risks. Clearly defining each risk category will be essential to have a common understanding among the staff of the Mi-MBA.

STEP 3: RISK ASSESSMENT

Once risks have been identified and listed, the next step is to systematically evaluate, rank and prioritize risks. The objective of

risk assessment is to come up with the “top” risks facing the Mi-MBA and not to argue over the order of ranking of a particular risk (e.g., whether it falls as number 4 or 5).

The risk assessment process will probably involve most if not all of the Mi-MBA staff, since majority only have less than 10 personnel. The big Mi-MBAs who have more staff, will be able to involve all and will need to select participants from the different units/ departments to participant in the ERM risk identification and assessment process.

Involvement of the Board is not a common practice, although this can be done if it is practical for the Mi-MBA to do so. Figure 7 shows the steps in assessing and prioritizing the top risks.

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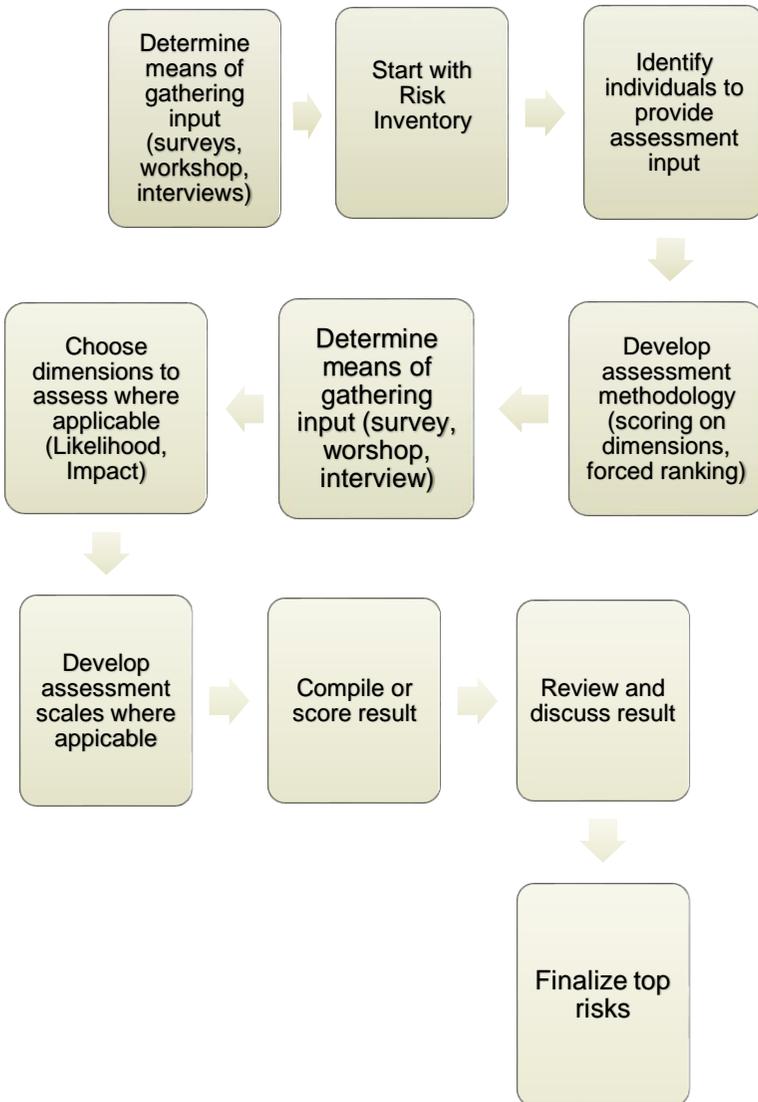


Figure 7: Steps in Assessing Risks

Risk Assessment Methods

Risk assessment techniques vary ranging from a qualitative, semi-quantitative and quantitative approach. The decision in which risk assessment method to use depends on the organizational constraints related to time, money, people, skills and management. In the context of Mi-MBAs, qualitative methods are the simplest and most practical.

There are 2 commonly used qualitative methods that can be used by Mi-MBAs. These are:

1. Dimension Scoring (Risk Matrix)
2. Forced ranking

A. Dimension Scoring (Risk Matrix) Method

The dimension scoring method starts with selecting certain dimensions (or factors) and assigning a score to assess the importance of risks. Two dimensions are commonly used: a) **likelihood of occurrence** and b) **severity of impact**. The combination of these 2 dimensions when placed in a matrix results into 4 general classification of risks (Figure 9). These are:

- High importance – high impact, high likelihood
- Medium high importance – high impact, low likelihood
- Medium low importance – low impact, high likelihood
- Low importance – low impact, low likelihood

Using Scales. Scales are used to allow for the consistent assessment of each of the dimensions by individuals participating in the process. Each Mi-MBA will need to develop a scale appropriate for their organization and define what each point in the scale means. It is important that all participants in the assessment process have a common understanding of the definition of each point in the scale.

The number of points per scale may differ depending on what suits the organization. The simplest scaling method uses a qualitative scale of low, medium and high.

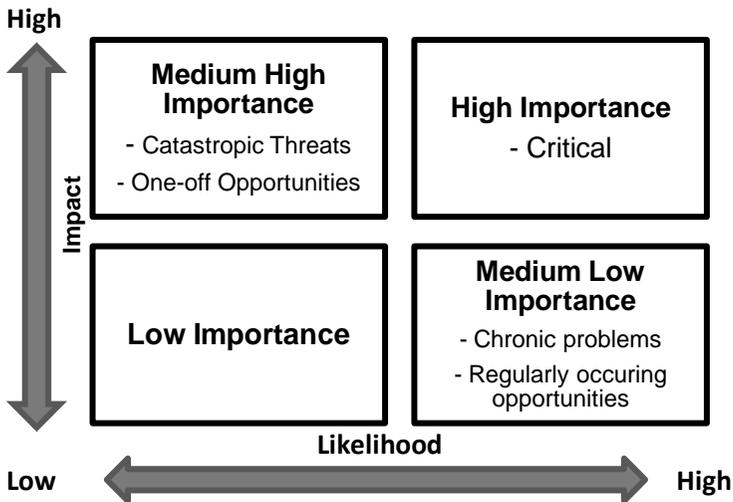


Figure 8: Risk Matrix

The most commonly used is a 5 point scale. An even numbered scale (e.g. 4, 6, and 8) is preferred by others to minimize the tendency to pick the middle option (central tendency). It is also a common practice to initially assess all inherent risks and ignoring any existing controls or response to the risks.

An example of a 6 point scale for “likelihood” is shown in the table below:

Rating	Likelihood	Probability of Occurring	Description
1	Rare/ Highly Unlikely	Less than 10% chance in one year	Very shocked if this happened

Rating	Likelihood	Probability of Occurring	Description
2	Unlikely	10% to 20% chance in one year	Shocking if this happened
3	Slightly Likely	20% to 40% chance in one year	Slight chance it might happen
4	Good chance	40% to 60% chance in one year	50-50 even chance it might happen
5	Highly Likely	60% to 80% chance in one year	Surprised if this did not happen
6	Definitely Likely	More than 80% chance in one year or once every 1-2 years	Almost certain it will happen

Figure 9: Sample of a 6 Point Scale for Likelihood and Occurrence

The next task is to determine the scale for impact. It is much more difficult and complex to develop a scale describing impact and quantifying risks. The table below is an example of a 6 point impact scale using both quantitative and qualitative description.

Rating	Impact	Quantitative Description	Qualitative Description
1	Insignificant	<ul style="list-style-type: none"> - Amount or % of pesos loss - % or number of client-members lost 	<ul style="list-style-type: none"> - Almost no financial loss - Insignificant impact on capital - Negligible effect on client retention - No loss to reputation - No regulatory consequences - No service disruption

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Rating	Impact	Quantitative Description	Qualitative Description
2	Slight	<ul style="list-style-type: none"> - Amount or % of pesos loss - Amount or % revenue lost - % or number of client members lost - Business disruption less of than 1 day 	<ul style="list-style-type: none"> - Minor impact on capital - Minor effect on client satisfaction or relationship - Few members affected
3	Moderate	<ul style="list-style-type: none"> - Amount or % of pesos loss - Amount or % revenue lost - % or number of client members lost - Business disruption more than 1 but not more than 2 days 	<ul style="list-style-type: none"> - Moderate impact on capital - Moderate client dissatisfaction and strain on relationship - Some members affected - Regulatory attention
4	High	<ul style="list-style-type: none"> - Amount or % of pesos loss - Amount or % revenue lost - % or number of client members lost - Business disruption from 2-7 days 	<ul style="list-style-type: none"> - Material impact on capital - Adverse reaction in the community - Many members affected
5	Very High	<ul style="list-style-type: none"> - Amount or % of pesos loss - Amount or % revenue lost - % or number of client members lost 	<ul style="list-style-type: none"> - Major impact on capital - Adverse reaction in the news - Most members affected

Rating	Impact	Quantitative Description	Qualitative Description
		- Business disruption more than 7 days	- Regulatory intervention
6	Severe or Catastrophic	- Amount or % of pesos loss - Amount or % revenue lost - % or number of client members lost	- Catastrophic impact on capital - Loss of reputation - All members affected - Cease operations

Figure 10: Sample of a 6 Point Scale for Impact

Severity of Risks. After scoring risks for likelihood and impact, the severity of the risk needs to be determined. The risk severity is the product of the likelihood and the impact (the score for likelihood multiplied by the score for impact). The degree of severity is based on a qualitative description (e.g., low, medium, high) with the corresponding quantitative description (the range of scores that fall under the description). For example, a low severity corresponds to scores from 7 and below as shown in Table 7 below.

Table 6: Sample Severity Scores

Tolerance Level	Severity Score	Equivalent in Severity Score
1	Low	Less than 7
2	Modest	7 to 14
3	Medium	15 to 23
4	High	Greater than 23

Color codes are also used to classify risk according to their level of severity.

- Risks with a high severity are in red (24 and above).
- Risks approaching the high severity levels are in orange (15 to 20).
- Risks with middle of the road scores are in yellow (8 to 12).
- Risks with low severity are in the green (2nd column, 1 to 6).

The table below illustrates the application of the severity scores (in Table 8) on a 6 point scale.

Table 7: Assignment of Severity Scores in the Risk Matrix

Severity Matrix

Likelihood	6	6	12	18	24	30	36
	5	5	10	15	20	25	30
	4	4	8	12	16	20	24
	3	3	6	9	12	15	18
	2	2	4	6	8	10	12
	1	1	2	3	4	5	6
		1	2	3	4	5	6
	Impact						

The risk severity result can be inputted in the risk inventory worksheet to describe the severity of each risk. The table below is an example of a risk inventory with the severity of each risk color coded.

Table 8: Inventory Worksheet Color Code

Risk Category	Risk	Likelihood	Impact	Severity
Operations	Risk 1	1	1	1
	Risk 2	6	5	30
	Risk 3	4	4	16
	Risk 4	2	4	8

In practice, prioritization can be very challenging. Comparing and balancing the threat of risks with a higher probability of occurrence but lower impact versus, risks with higher impact but lower probability of occurrence, can be difficult.

Forced Ranking Method

An alternative approach to dimension scoring is the forced ranking method. The main advantages of this approach are the following:

- a. No assessment scales are needed to be devised.
- b. Process is faster to complete as there are no dimensions (likelihood, impact, etc.) to compare.
- c. This method is said to result to more dispersion of scores compared to the risk matrix which tend to cluster towards the middle.

Under the forced ranking method, the following steps are undertaken:

1. **Choose top 10 risks.** Each individual providing input in the risk assessment process is asked to choose what they believe are the top 10 risks from the risk inventory. Risks are ranked with 10 as the most important and 1 as the least important.
2. **Tabulate the frequency distribution of responses.** The frequency of responses from all participants are tabulated for each risk according to ranking (Table 10). The 1st among the top risks is assigned 10 points, the 2nd is assigned 9, the 3rd 8th down to the 10th risk being assigned 1 point. In the example below, Risk A was ranked by 3 participants as the top risk (10 points), 2 participants ranked it as the 2nd top risk (9 points), and 1 Participant rank it as the 3rd top risk (8 points) and so on.

Table 9: Forced Ranking Distribution Table

Importance/Risk Identified	10	9	8	7	6	5	4	3	2	1
Risk A	3	2	1	1	1	1	0	0	0	0
Risk B	2	1	1	1	2	1	0	0	1	0
Risk C	2	1	2	2	0	0	0	0	0	2
Risk D	1	2	1	0	1	2	0	1	0	1
Risk E	1	1	1	1	0	2	0	2	0	0
Risk F	1	1	1	1	3	1	1	0	0	0
Risk G	0	1	1	1	2	0	0	2	1	0
Risk H	0	1	1	0	1	1	1	1	1	0
Risk I	0	0	0	2	0	1	2	0	0	1
Risk J	0	0	0	0	0	1	2	2	0	1
Risk K	0	0	0	0	0	0	2	2	1	1
Risk L	0	0	1	0	0	0	0	0	2	2
Risk M	0	0	0	1	0	0	1	0	1	0
Risk N	0	0	0	0	0	0	1	0	3	2
Total Responses	10	10	10	10	10	10	10	10	10	10

3. **Calculate scores.** The total risk score is calculated by multiplying the frequency of responses by the assigned points and adding up all the scores. As an example, for risk A, the total score is calculated as follows:

$(10 \times 3) + (9 \times 2) + (8 \times 1) + (7 \times 1) + (6 \times 1) + (5 \times 1) + (4 \times 0) + (3 \times 0) + (2 \times 0) + (1 \times 0) = 74$. The same method of calculation is applied to all risks. After all scores are derived, risks are ranked from highest to lowest. Those with the highest scores are the top priority risks. Table 11 below shows the aggregate scores and the ranking of risks based on total scores.

Table 10: Forced Ranking – Scores

Rank	Risk Identified	10	9	8	7	6	5	4	3	2	1	Total
1	Risk A	30	18	8	7	6	5	0	0	0	0	74
2	Risk B	20	9	8	7	12	5	0	0	2	0	63
3	Risk C	20	9	16	14	0	0	0	0	0	2	61
4	Risk D	10	18	8	0	6	10	0	3	0	1	56
5	Risk E	10	9	8	7	0	10	0	6	0	0	50
6	Risk F	10	9	8	7	6	5	4	0	0	0	49
5	Risk G	0	9	8	7	12	0	0	6	2	0	44
6	Risk H	0	9	8	0	6	5	4	3	2	0	37
5	Risk I	0	0	0	14	0	5	8	0	0	1	28
6	Risk J	0	0	0	0	6	5	8	6	0	1	26
5	Risk K	0	0	0	0	6	0	8	6	2	1	23
6	Risk L	0	0	8	0	0	0	0	0	4	2	14
5	Risk M	0	0	0	7	0	0	4	0	2	0	13
6	Risk N	0	0	0	0	0	0	4	0	6	2	12

Evaluating the Risk

Once the top risks are prioritized, a decision has to be made whether a risk is acceptable or not. A risk is considered as acceptable when the risk is sufficiently low that treatment will not be cost effective or the risk treatment is not available.

If management determines the risk to be acceptable, the risk may be tolerated with no further action for treatment beyond the control measures already existing. Acceptable risks should be continuously monitored and periodically reviewed to make sure they remain at a tolerable level.

STEP 4: RISK TREATMENT

If a risk is found to be unacceptable, the next step is to treat the risk. The objective of this step is to find a cost-effective option of treating the risk. It involves one or more treatment options which are not necessarily mutually exclusive or appropriate in all situations. Treatment decisions must be in accordance with legal and regulatory requirements.

A treatment once implemented, becomes a control or modifies an existing control. There are 4 general treatment options:

Tolerate. This action is chosen when the risk is acceptable, control is impossible or cost of control exceeds the potential benefit. Contingency plan can be put into place to handle any potential impact.

Transfer. Transferring risks is an option that works well for risks to asset risks by paying a third party to take over the risk (such as reinsurance). This option is not possible for other types of risks such as reputational risks.

Reduce. There are many options to reduce or mitigate risks. This can include deploying of additional resources (e.g. people, technology, equipment, etc.), setting up new or revising existing control measures, streamline operations and improving staff capacities.

Avoid. Avoiding risk may be the easiest action to mitigate risk. This can be done by foregoing certain strategies or terminating activities that jeopardize the business. However, avoiding risks also means avoiding potential gains.

It is possible to identify possible treatment options using the Risk Matrix (Figure 11).

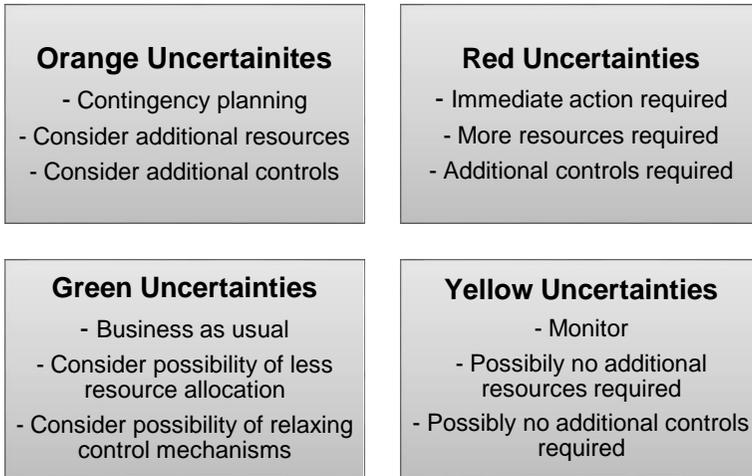


Figure 11: Risk Treatment and Response Matrix

STEP 6: RISK CONTROL

The next step is to decide on whether the strategies identified to control risks will be implemented. These control measures include policy, procedures, practice, process, technology, methods and devices that scales down the severity of the risk.

The proposed control measures have to be carefully weighed in terms of their cost and the corresponding benefit to the organization. It may not be worthwhile to pursue the action should the additional costs exceed the benefits. It is also possible that control measures may divert critical resources from more important activities of the Mi-MBA.

Once a decision to implement control mechanisms are taken, a risk management plan has to be put into place by the risk owner. The plan should include the key activities, performance indicators to measure the completion and effectiveness of risk treatment activities and results.

STEP 7: MONITOR AND COMMUNICATE RISK

The last step of the risk management process involves monitoring and communicating risks. The main objectives of this step are to:

- 1. To determine whether the ERM process is working.** Monitoring of the ERM process on a regularly basis is essential to find out the status of implementation and effectiveness of ERM. Any deviations must be reported to allow for corrective actions to be taken. Lesson learnt must be fed back and improvements made to the ERM framework and process.
- 2. To find out whether risk treatment strategies adopted are sufficient or need further action.** Monitoring needs to regularly assess the adequacy and effectiveness of treatment measures. This will allow management to reassess the risk and decide whether additional control measures are necessary.
- 3. To assess whether the risk profile has changed.** Monitoring must also continuously assess the internal and external environment of the Mi-MBA. This will allow for the early identification of new emerging risks, discontinuance of control treatment for downgraded risks and re-distribution of resources based on the revised risk profile.
- 4. Reporting.** Risk reports need to be prepared periodically by the Mi-MBAs chief risk officer and made available to both internal and external users. Two types of reports are proposed:
 - A. Own Risk Assessment Risk Report** - A Comprehensive Own Risk Assessment Report is prepared annually by the Mi-MBA's Risk Officer for submission to the Board of Directors,

RIMANSI (Mi-MAP) and to government regulators. The content of the report includes the following:

- 1) A summary of the significant risks;
- 2) Risks that exceed the acceptable risks level;
- 3) Risk management decisions taken to bring risks to acceptable levels and the status of implementation to bring risks to acceptable levels;
- 4) New and emerging risks including their assessment
- 5) The trend of each risk (whether decreasing, stable, or increasing) and the effectiveness of the methodologies and procedures to manage each risk (whether weak, acceptable or strong) based on the definitions stated below.

Weak:	There are significant gaps in the methods, procedures and controls. The methods, procedures and controls are not fully documented. The methods, procedures and controls effectiveness cannot be assessed.
Acceptable:	The methods, procedures and controls are reasonable and appropriate including cost/benefit considerations. There are possibilities to further improve the methods, procedures and controls. The methods, procedures, and controls may either a) not be fully documented b) not fully implemented or c) not fully followed.
Strong:	The methods, procedures and controls are appropriate to the risk, are documented, and are implemented and fully followed.

- 6) Additional actions that may be required to improve risk management.

B. Monthly Risk Report – a monthly risk report is a useful tool for management to monitor planned activities to treat the

risk and to determine any change in the severity of the risk. The simplest method is using the color codes to monitor any change in severity of the top ten risks. A sample report is shown in the table below.

Table 11: Risk Monitoring Report

Priority Risks	January	February	March	April	May
Risk 1					
Risk 2					
Risk 3					
Risk 4					
Risk 5					

The report provides an indication whether the risk management activities implemented were effective in treating the risks.

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