



Killer Risks: Torpedoes in the Water

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Killer risks

- Arrogance
- Rainmaker
- Mastermind
- External power concentration
- Internal communications
- External communications
- Tail risk myopia
- Combination punches

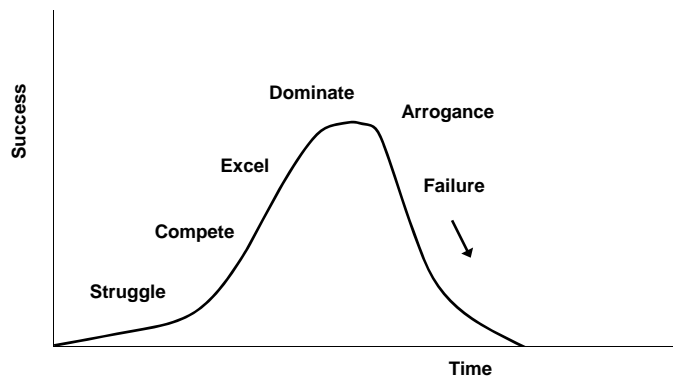
Most killer risks share 3 qualities

- Politically difficult to introduce
- Easily identifiable
- Leading indicator of high-severity risk events

Arrogance

- Attitude of invincibility
- Politically difficult
- Easily identifiable
 - Insular attitude
 - Lack of self-criticism
 - Overly-praising of self
 - Overestimation of strengths / underestimation of vulnerabilities

Leading indicator of high-severity risk events



Examples

- Swiss watchmakers
- United States post WWII/Sputnik
- General motors

Possible mitigation

- Focus on weaknesses resulting from the behavior, not the behavior itself
 - Unrealistic strategic plans
 - Address by integrating ERM into strategic planning
 - Lack of competitive analysis, benchmarking
 - Address directly through business segments
 - Address indirectly through emerging risk identification

Rainmaker

- Individuals or business units generating very high growth
- Politically difficult
- Easily identifiable
 - Peacock-like attitude
 - Highly compensated

Leading indicator of high-severity risk events

- Typical progression
 1. Recognition of talent
 2. Massive, rapid growth
 3. Implosion
- Why does this occur?
 - Lack of scrutiny
 - Pressure

Examples

- Long Term Capital Management
- Fukushima
- David Sokol

Possible mitigation

- ERM policy to automatically enhance scrutiny with abnormally high growth
 - Risk and return go together
 - Automatic nature avoids direct confrontation
- Value-based ERM approach
 - Blunts argument that value generated overwhelms any risk concerns
 - Use as entrée to quantify both value and risk

Mastermind

- Individuals with unique intelligence/mastery in area of expertise
- Politically difficult
- Easily identifiable
 - Highly respected and widely known both internally and externally

Leading indicator of high-severity risk events

- Create a large vacuum when they leave
 - Difficult to replace the individual
 - Tend not to share information
 - Tend not to develop people under them
- If stolen by competitor, doubly impactful

Examples

- CFO of large financial services company
- Rupert Murdoch
- Steve Jobs

Possible mitigation

- Raise as talent management issue to mitigate “rare talent concentration risk”
 - Emphasizes valuable nature of individual
 - Committee approach to identifying individuals
- Leads to enhancements:
 - Succession planning for mastermind
 - Establishment/development of supporting cast
 - Documentation/sharing of critical information

External power concentration

- Disproportionately high concentration of power in an external party
 - Critical supplier, large customer/distributor
- Politically difficult
 - Challenges powerful entities and their powerful internal allies
- Easily identifiable
 - Management is well aware of these

Leading indicator of high-severity risk events

- Should they be lost, either partially or entirely, there is a large impact, proportional to the concentration

Examples

- Bernie Madoff
- Monoline insurer

Possible mitigation

- Quantify to reveal true impact on value
 - May lead to diversification strategy
 - Example: Cleaning products manufacturer
 - May result in corporate support of business segment initiatives to maintain critical relationship

Internal communications

- Failure to share risk scenarios horizontally or vertically in the organization
- Examples
 - September 11th
 - Space shuttle disaster
 - Operation Eagle Claw
- Possible mitigation
 - Formal robust risk scenario development process
 - Formal meetings between risk committees

External communications

- Failure to properly disclose risks to shareholders
 - The single most overlooked risk
- Example
 - Banks
 - Research study
- Possible mitigation
 - Quantify risk scenarios in terms of their potential impact on company value

Tail risk myopia

- Limiting focus to just worst-case scenarios
 - Often misses even more severe exposures (worst-case not found until range of scenarios quantified)
- Possible mitigation
 - Formal robust risk scenario development process

Combination punches

- Multiple events occurring simultaneously
- Examples
 - Financial crisis
 - Monoline
 - Fukushima
- Possible mitigation
 - Quantify multiple simultaneous risk scenarios

Contact information

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