

Enterprise Risk Management

John K. Smith
President and CEO
Pennsylvania Lumbermens Mutual Insurance Company


Hardwood Manufacturers Association
2019 National Conference & Expo



EVERYDAY



THE AVERAGE HUMAN TAKES

 **35,000**
RISKS

Where do you see your
company in a year? 5? 10?

What will keep it from getting there?

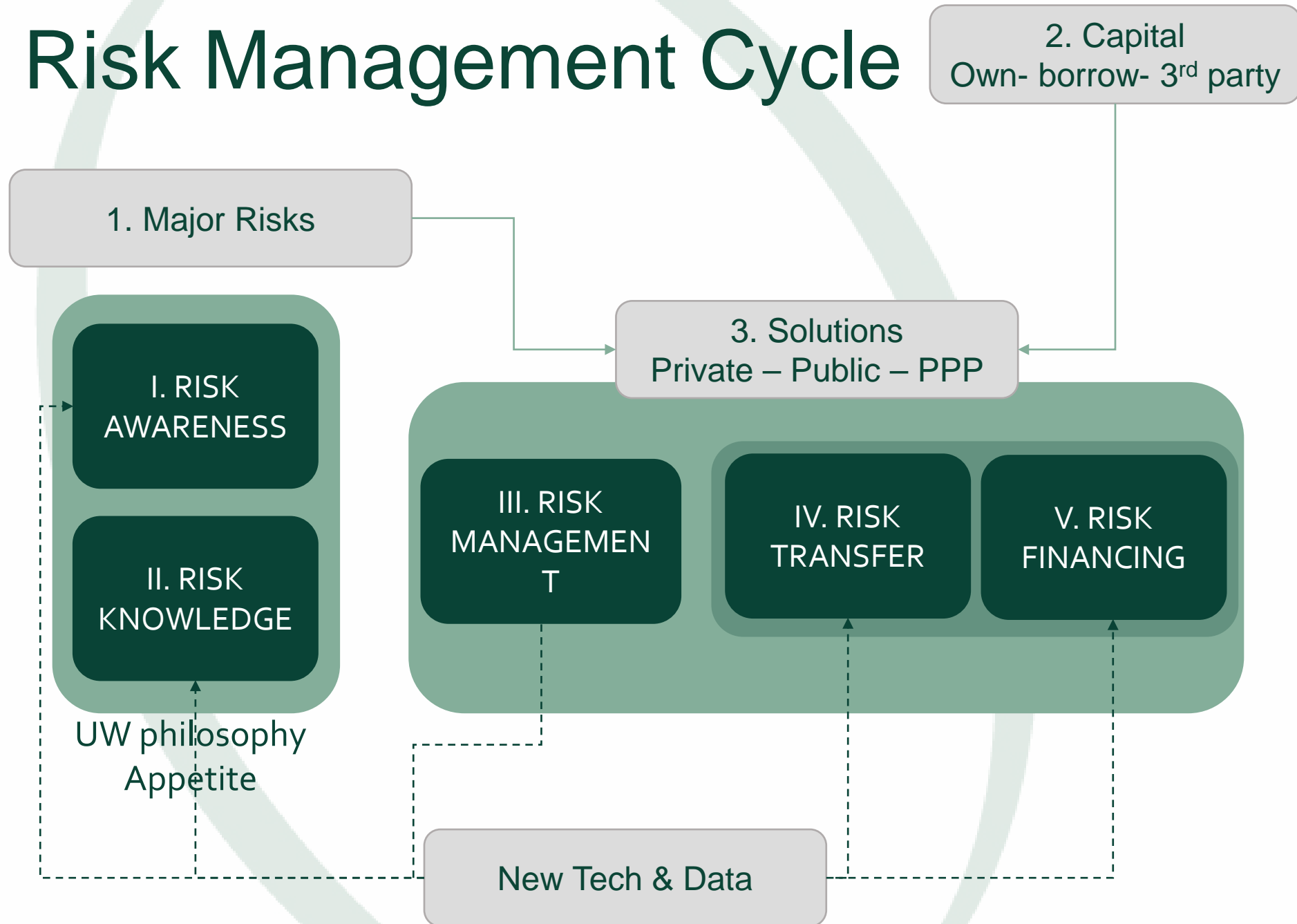
Inability to

CONFRONT & OVERCOME

or **TAKE ADVANTAGE OF**

risk

Risk Management Cycle



Risk as a Business Decision

- Conscious effort
- Needs to be a part of EVERYDAY conversation and thought
- Understand your risk **tolerance**
- Develop a risk **strategy**
- Can risk be a competitive advantage?
 - Only if it is **actively** managed

Enterprise Risk Management

- **Business** decision making **process** to:
 - **Identify** and **analyze** known and emerging risks
 - **Manage** enterprise risks
 - **Anticipate** imminent and long-term risks
 - **Manage** uncertainty

Enterprise Risk Management

- Provides knowledge to:
 - Capitalize on opportunities
 - Avoid the pitfalls of the unknown
- Anticipate, predict, and mitigate the impact of adverse events
- Capitalize on opportunities while consciously considering risks versus benefits
- Improve compliance oversight
- Foster culture and collaboration amongst organizational divisions
- Enhance leadership through informed consensus decision-making

Risk Management Responsibilities of...



- The Leader (Owner, CEO, etal.)
 - Determine strategic approach to risk and set appetite
 - Interact with external advisors
 - Establish structure for risk management
 - Understand the most significant risks
 - **What keeps you up at night?**
 - Manage the organization in a crisis

Risk Management Responsibilities of...



The Leader

The Manager

The Employee

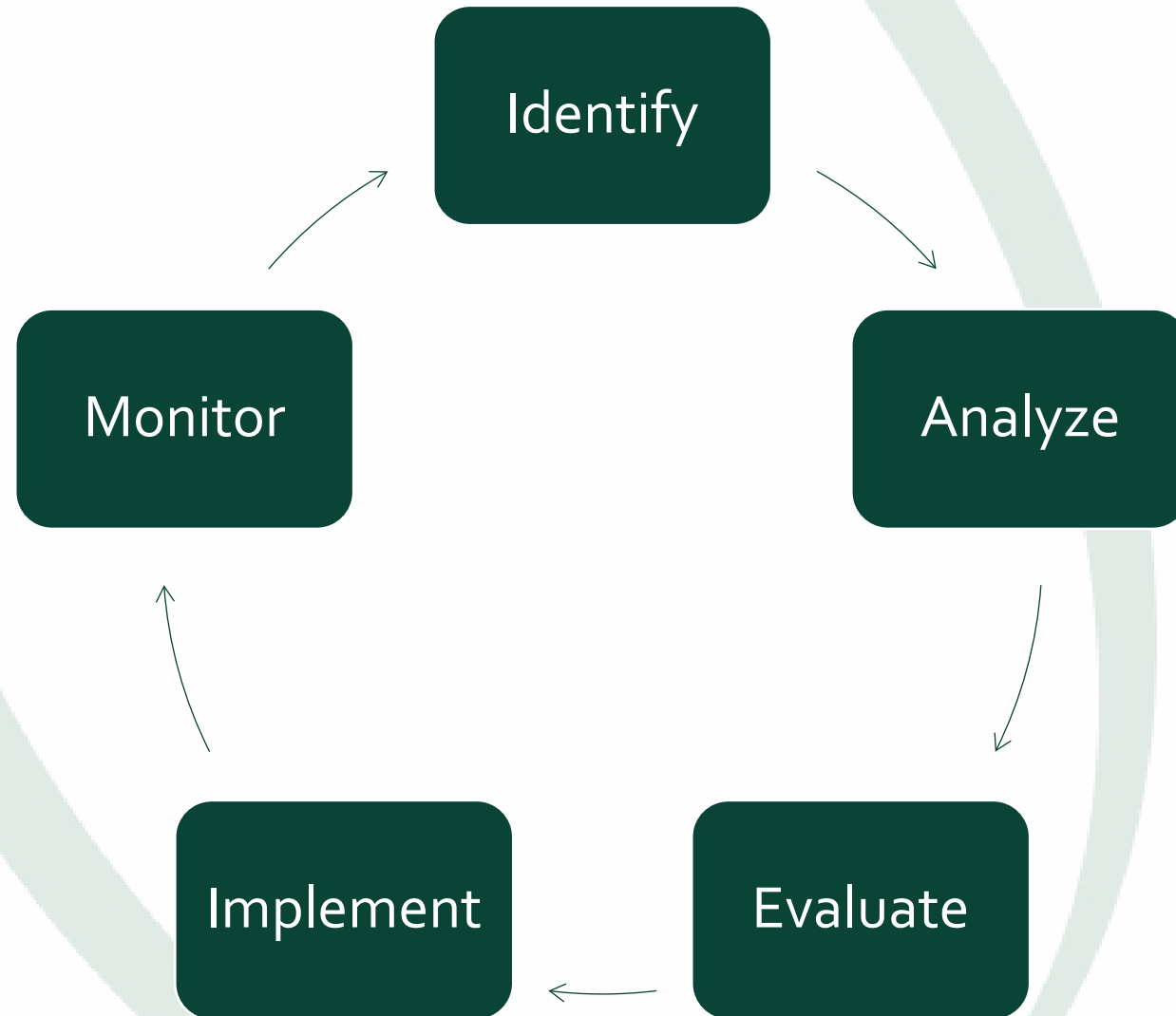
- The Manager
 - Build a risk aware culture within the shop
 - Set and follow up on risk management performance targets
 - Successful implementation improvement recommendations
 - Identify and report changed circumstances and evolving risks
 - Report recommendations for improved risk management techniques to senior management

Risk Management Responsibilities of...



- **The Individual Employee**
 - Understand, accept, and implement (practice) risk management techniques
 - Report inefficient, unnecessary, or unworkable processes and controls
 - Report evolving risk exposures to management
 - Report loss events and near miss incidents
 - Cooperate on incident reviews

Risk Management Cycle



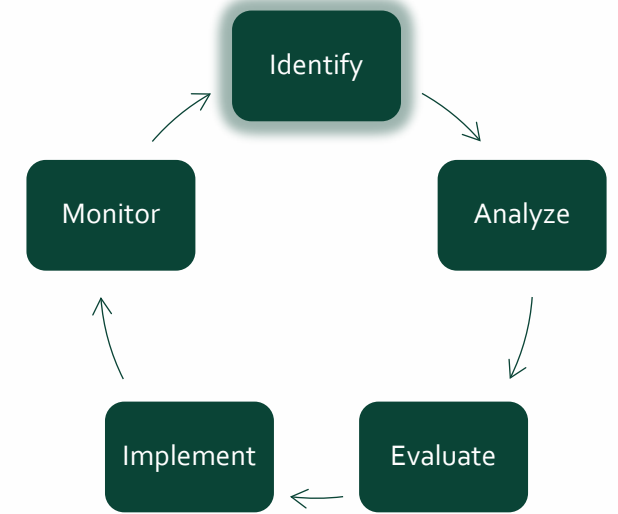
Identify Risks

Hazard

Operational

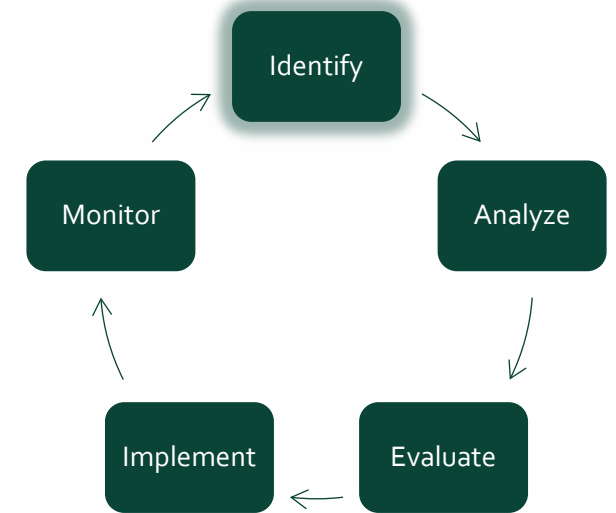
Financial

Strategic



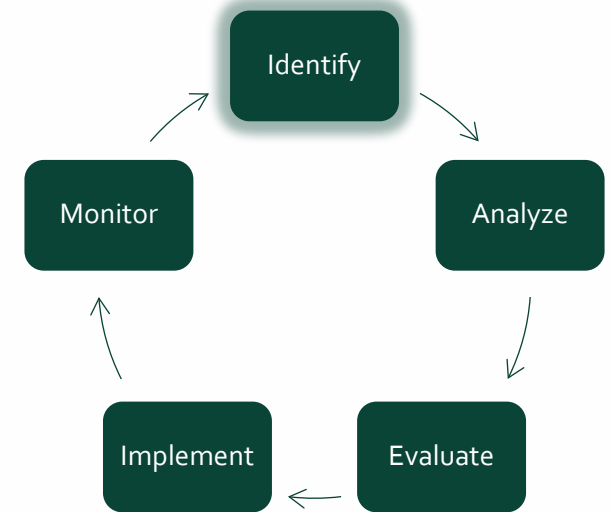
Hazard

- Pose a level of threat to organization
- Thought to be insurable risks
 - Property, Liability, Catastrophe, Auto Liability, Auto Physical Damage, Workers Compensation
- Uninsurable effects of Hazard risk?
 - Operational Risks
 - Financial Risks
 - Strategic Risks



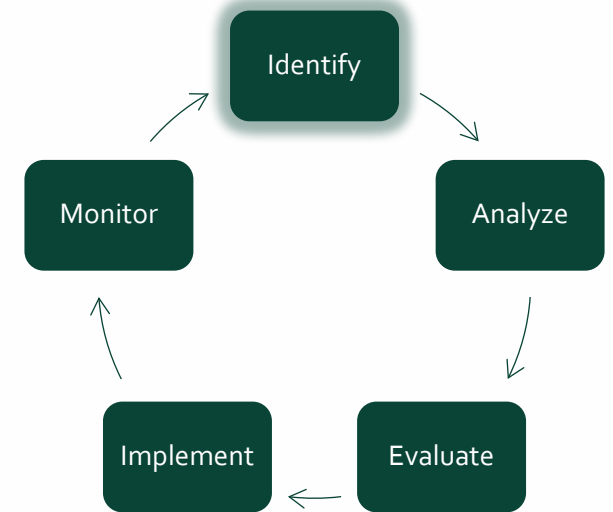
Operational

- Product Failure
- Customer Satisfaction
- Reputational Risk- can you come back from it?
 - Clinton vs. Trump
- Cyber Risk
 - John Smith as a name
 - Phishing Scams
- Systems Risk
 - What if they don't turn on tomorrow?
 - Breach or Cyber attack
- Effective and Efficient use of resources



Operational

- Employee Risk
 - Do you have the right people?
 - Training
 - Retention
 - Succession Planning- multiple levels
 - Fraud Awareness
 - Reputation and Ethics
- Effective and Efficient use of human capital



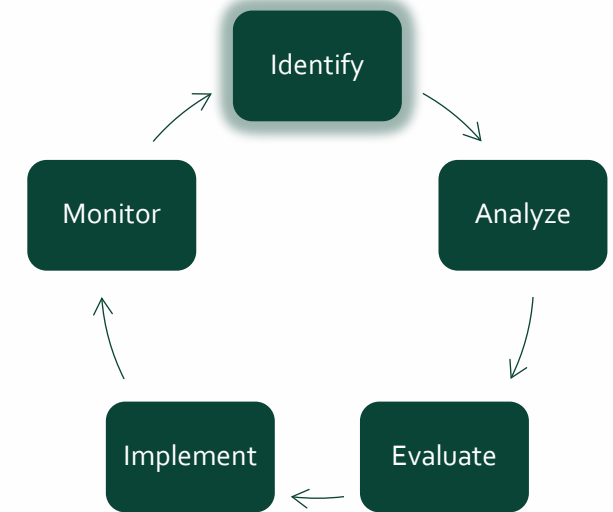
Financial

External Risks

- Economy
 - Domestic vs. International
- Housing market
- Consumer confidence
- Concentration
 - Unemployment level
- Exchange rate
 - Dealing internationally

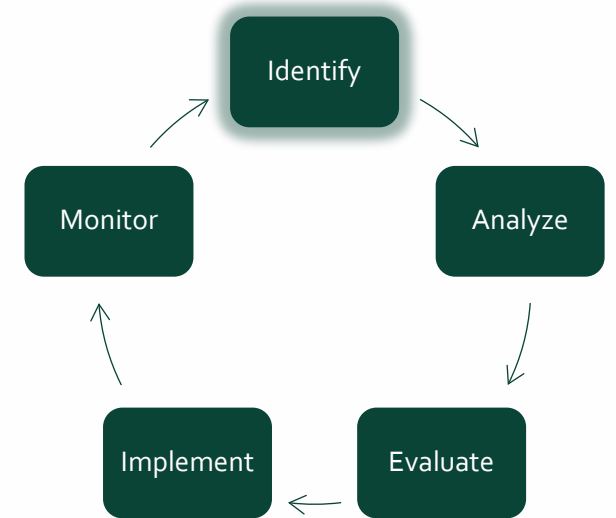
Internal Risks

- Cash flow
- Financial flexibility
 - Collections
 - Are your customers solvent?
 - Banking relationship
 - Line of credit
- Expense
 - Variable
 - Fixed
- Fraud awareness



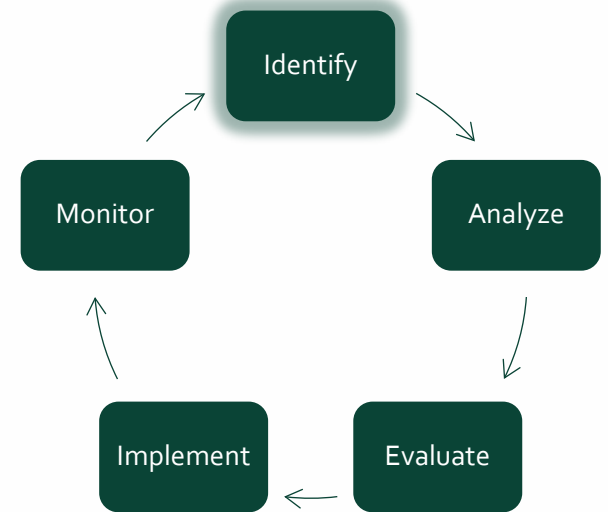
Strategic

- Competition
 - Is your market share stable?
 - Are there minimal or significant barriers to entry?
- Social and Economic Trends
 - Are you able to provide the products sought by customers?
 - How will sales be affected by:
 - Downturn in economy?
 - A new generation of individuals becoming employees and customers?
 - Environmentalists?
- Capital Availability
 - Can you afford to adapt? Improve?



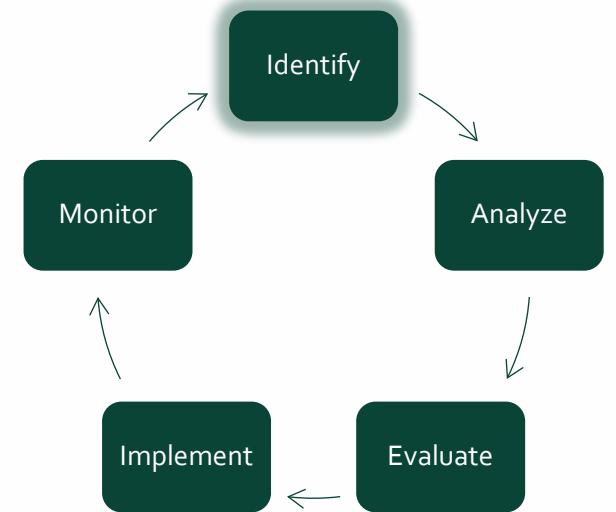
Strategic

- Reputation
 - Are you prepared to recover in the time of a crisis?
 - Are your customers loyal because of your reputation?
- Human and Customer Capital
 - If unemployment is low, more competition exists for jobs
 - Do you have access to the talent pool you need?
 - Can they carry your company viably into the future?
- Culture
 - What is the risk to your operation, performance, and reputation if culture is not instilled at all levels?
- Governance
 - Do you have a board?
 - Lumber Dealer family forced out long term manager
 - Is it functional?
 - Do you have a plan for the future?



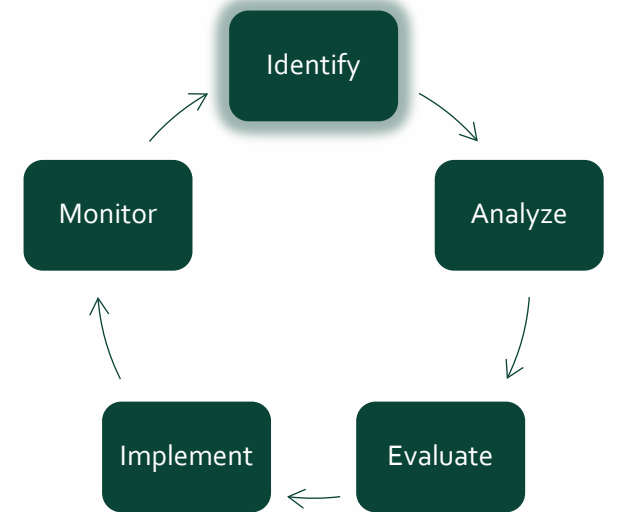
How to Identify Risks

- Engage in consistent conversation with:
 - Employees
 - Customers
 - Vendors and Suppliers
 - Competition
 - Associations
 - Outside experts
- Surveys
- Forums
- Networking



How to Identify Risks

- Checklists
- Inspections
- Audits
 - Financial
 - Process
 - Product
- Flowcharts
- Dependencies Analysis
- Strengths, Weaknesses, Opportunities, Threats (SWOT) Analysis



PLM Enterprise Risk Management

Studies Engaged

- WARD Benchmarking
- PIPES (NAMIC/NEAM Financial Benchmarking)
- Internal Audit Implementation (Baker Tilly)
- Self Audit (operational in all departments)
- Reinsurance Audit (Claims and Underwriting)
- Actuarial (KPMG)
- University of Virginia monthly economic data report
- Insurance Department Financial Examination
- Quarterly “Deep Dive” Investment reviews implemented
- IT Annual Security Risk Assessment

Other Sources

- Reinsurance Conference
- Insured Conference/one-on-one visits
- Industry Group Participation (NHLA, AHEC, NLBMDA, Federation)
- Large Loss Meetings
- Ward/Aon Human Resource study evaluation
- Vendor Review
- Novarica Insurance Technology Research Council
- InfoTech Research Group

Emerging Risks Definition

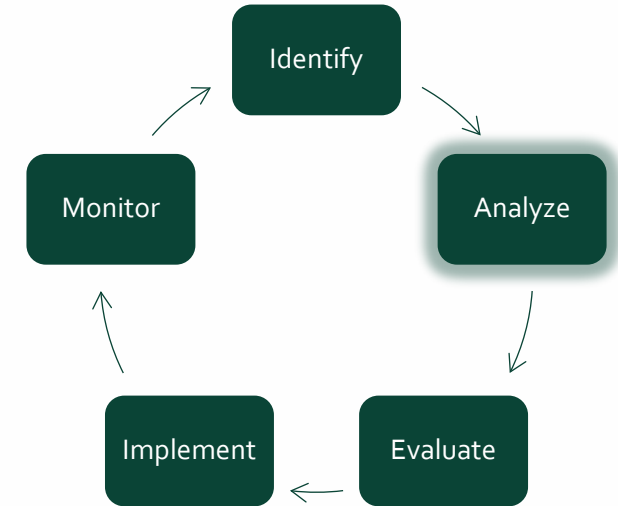
- Potential danger or risk content is not yet reliably known
- Implications are difficult to assess
- Emerging Risks include risks that:
 - Have arisen recently
 - Are anticipated in the future
 - Were known previously
 - Evolving character or show
 - Changing dynamics
- Emerging Risks entail both **RISKS** and **OPPORTUNITIES**

PLM Emerging Risks Watch List

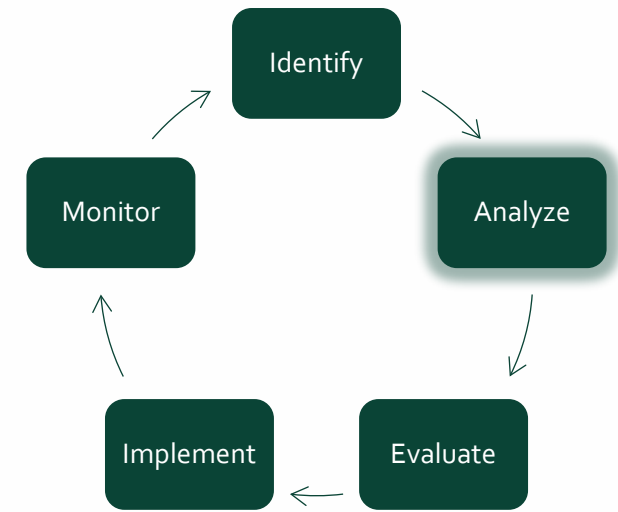
Risk	Status
Niche Viability	Monitored
Reinsurance Partners Commitment	New players on board program oversubscribed on renewal
Board Governance	Transition
Compliance	Under review by Internal Audit
Policy/Procedure Documentation and Availability	Root Source Rolled out and gaining broad based traction
"Round Up" Litigation	Developing

Analyze Risks

- Put weight around the risks identified
- What does the risk represent to your company?
 - Based on company plans, goals, & strategy
- How?
 - Impact vs. Likelihood
 - Stress test
 - Guess?



Analyze Risks



CORRELATION RISK

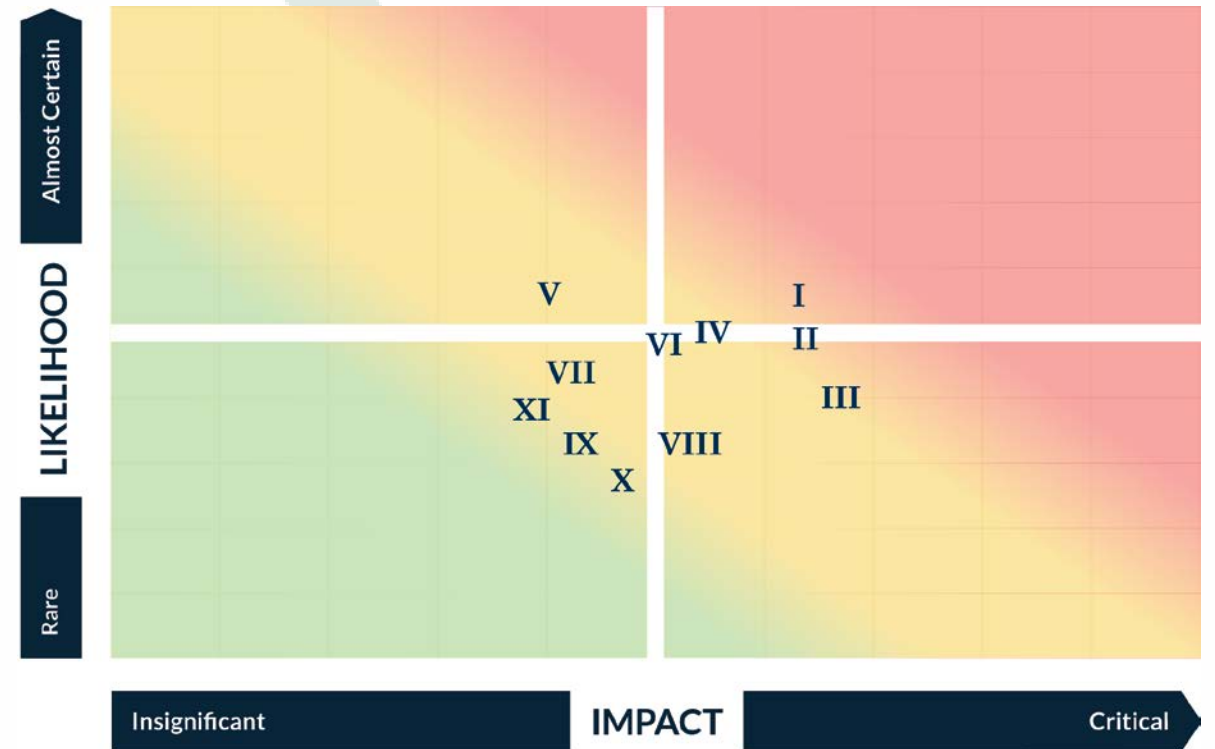
The risk associated with the interaction of other categories of risk; the realization that other types of risk that arise at the same time can leverage up the total risk

PLM Correlation Risk

- Underwriting result/investment leverage
 - 2018 reaction: downsized market to market holdings dramatically
- Housing/Economic/Consumer Confidence/Risk Quality
- P/C Marketplace/Investment Risk
- Underwriting profitability/reinsurance stability

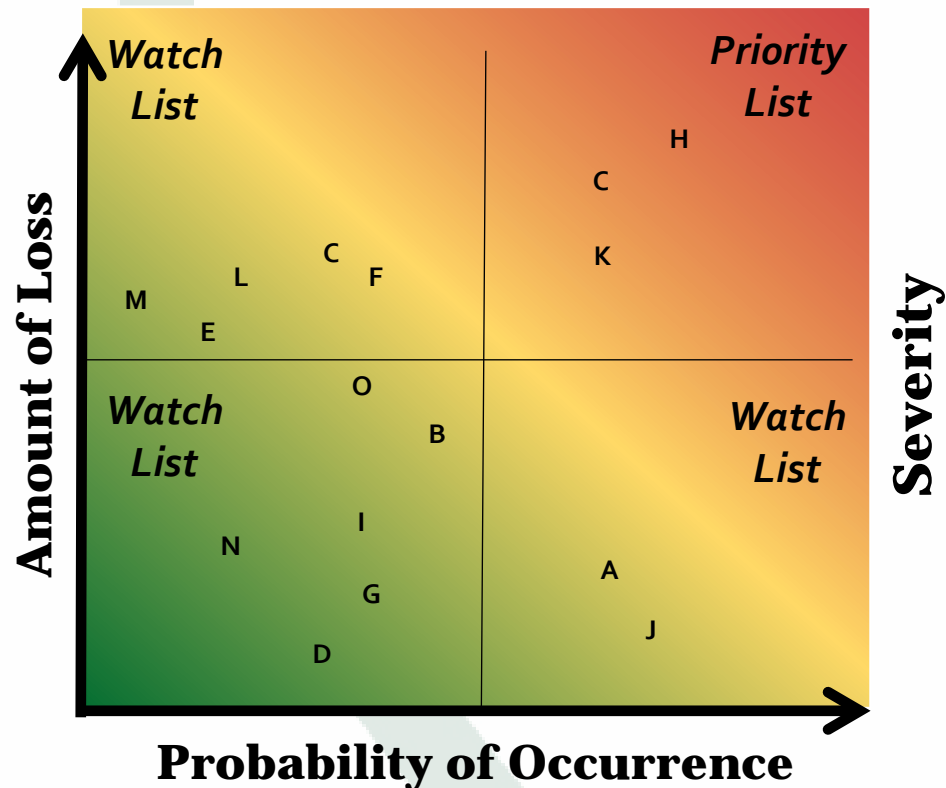
Risk Heat Map

- Gains credibility with stakeholders
- Identifies aggregate opinions
- Allows risks to be reviewed within a structured context while considering strategic, reputational, technology, compliance, operational, and financial impacts and benefits
- Cyclical & repeatable process
- Point in time view of identified risks
- Shifts over time
 - Emerging risk; less or more confidence in management, etc.



PLM Emerging Risks

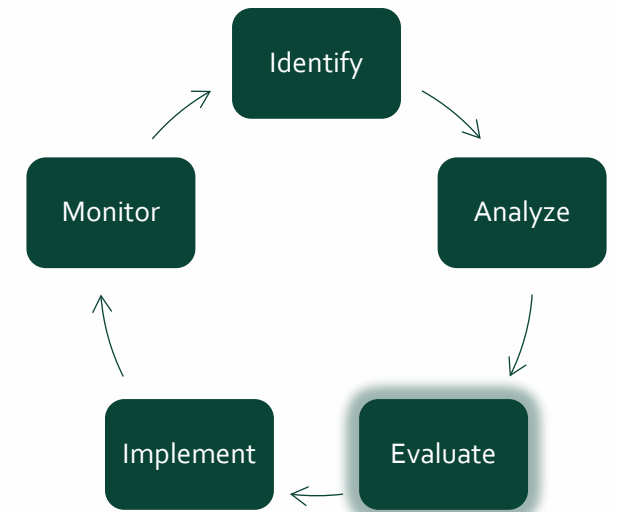
Visualization of the Risk Attributes and Their Development with Time



- A. Housing Industry/General Economic Condition
- B. CAT
- C. System Disruption (non-breach)
- D. P/C Marketplace Disruption
- E. Investment Disruption
- F. Senior Staffing Disruptions
- G. Reinsurance
- H. Underwriting Profitability (P/C)
- I. Pension Conversion
- J. Construction Defect
- K. Cyber Breach
- L. Internal Audit
- M. Board Age
- N. Disaster Recovery
- O. Front Line Staffing / Development

Evaluate Risk Management Options

- Determine which risks need to be addressed
 - Based on weighted analysis
- Cost Benefit Analysis
- Assign responsibilities



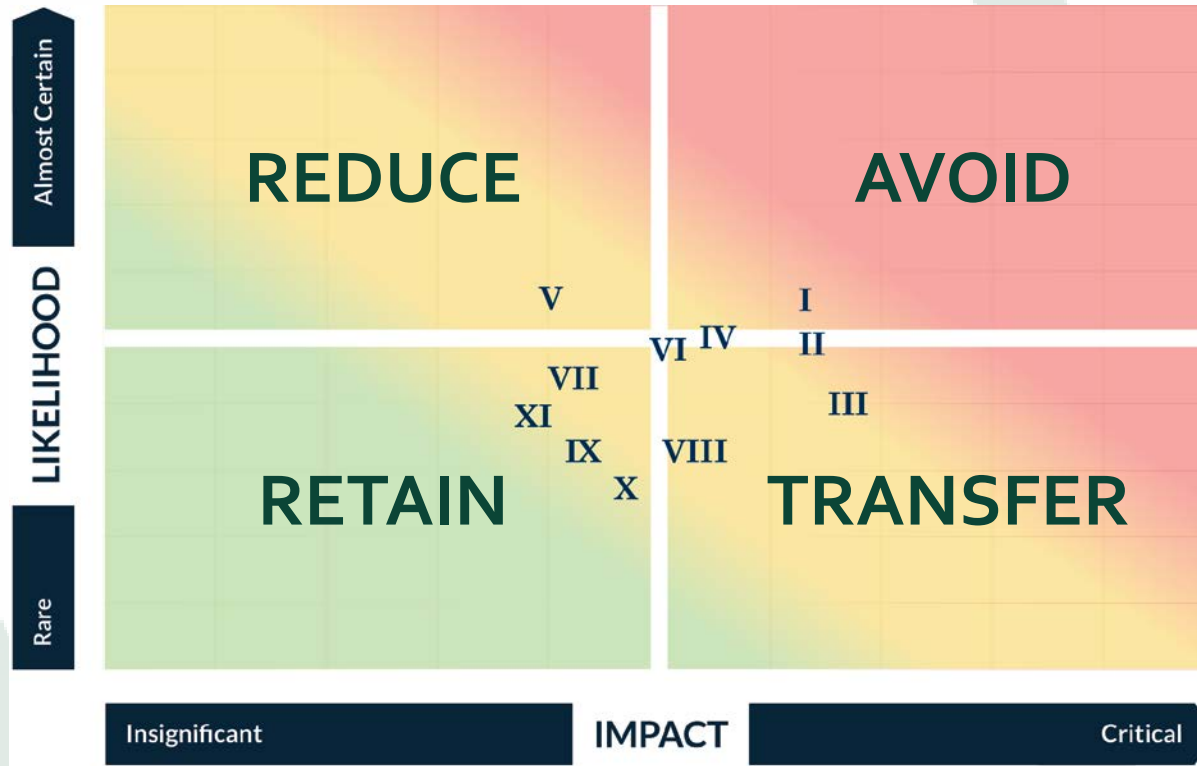
Evaluate Risks: Beyond the Heat Map

- What do you do with Heat Maps?
- Risk assessments
 - Who owns the risk?
 - What functions does it affect?
 - What level of action is required?
 - Monitor vs. act
- Prioritization
 - What has the largest loss potential?
 - Dependent on knowing your risk tolerance and objectives
- Who owns enterprise risks?
- What is the structure to monitor and manage?
 - Determine upfront when setting success factors

Evaluate Risk Management Options

- Separation
- Duplication
- Diversification

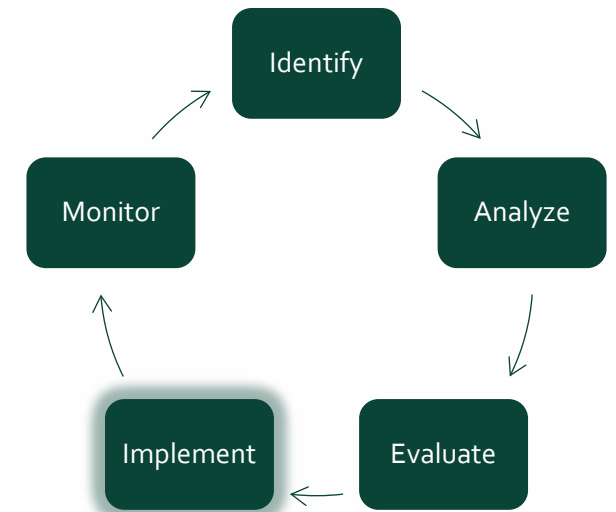
- Monitor
- What would cause the risk to move?



- Is this always feasible?
- What is the opportunity cost of avoiding risk?
- Insurance
- What other risk financing vehicles?
 - Outsourcing?

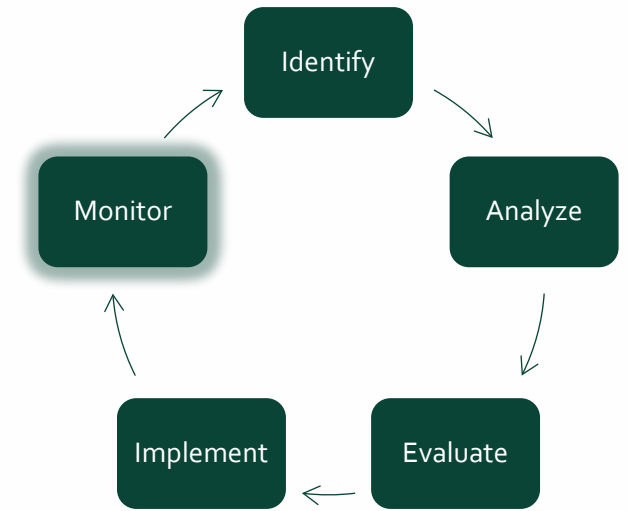
Implement Solutions

- Actively choose how to address risks
 - Action on top risks
 - What does “top” mean to you?
 - Monitor remaining
 - Still an active choice
- Key factors for success
 - What do you wish to accomplish?
 - Capitalize on risk?
 - Reduce risk?
 - Monitor risk?
- Financing
- Management
- Communication



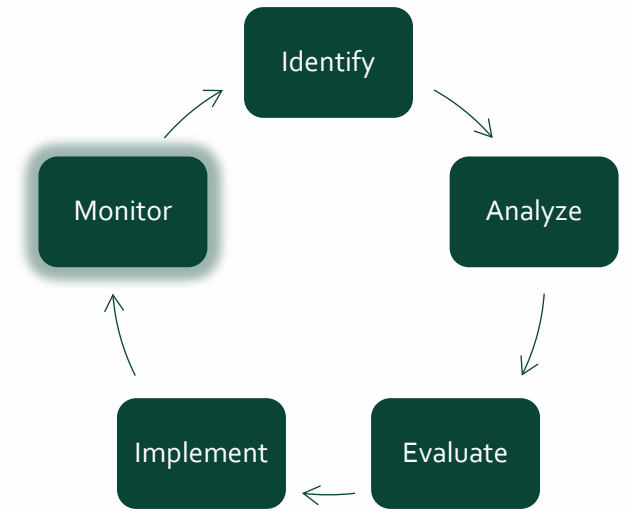
Monitor Results & Outcomes

- Create standard procedure for collecting periodic follow ups
- Communication
 - Ongoing
 - Top down
 - Bottom up
- Culture
 - Trust
 - Are your employees comfortable raising their hand?



Monitor Results & Outcomes

- Continuous evolution
- Modify and revise as needed
 - Risks
 - Analyses
 - Solutions

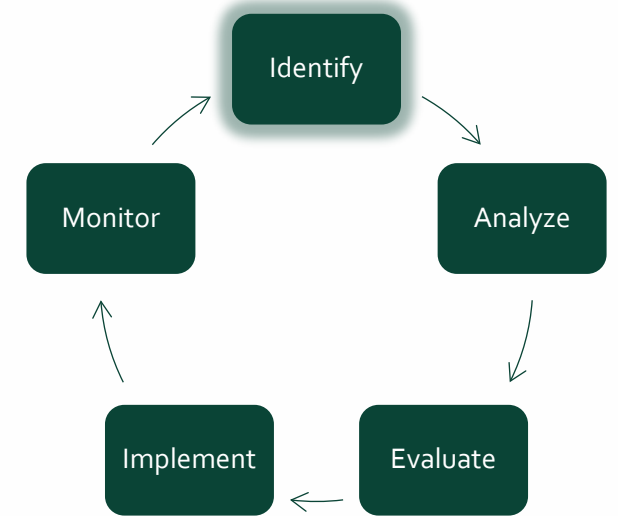


What does this look like to me?

Hardwood Industry Case Study

Hazard

- Property Damage
 - Collapse, Equipment Breakdown, Electrical, Fire
- Liability
 - Construction defect, pickup and delivery, Installation
- Auto
 - Loading/unloading, distracted driving, load securement
- Workers Compensation
 - Machinery Injury, Back Injuries
- Personal Injury



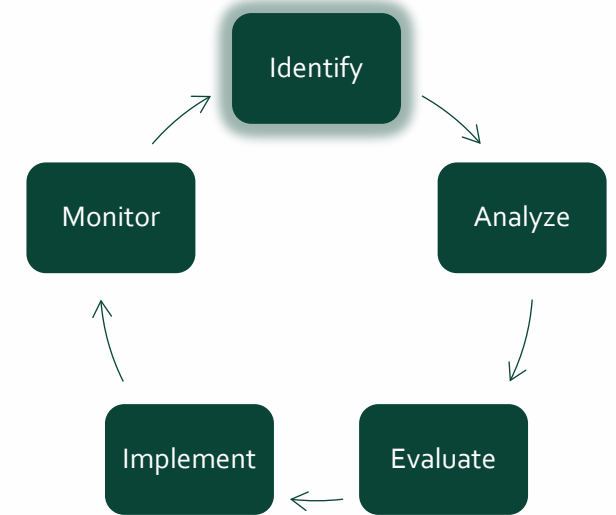
What is the true cost of a fire?

More than what is insurable

Introducing Jeff Hanks, President of Bill Hanks Lumber Company

Operational

- Supply Chain Management
 - Reliance on vendors- do you have backups?
 - Machinery- industry standard or special order?
 - How much downtime will a loss to machinery cause?
 - Bottlenecks
- Aging Workforce
- Talent Gap- Commercial Auto
- Cyber Security
 - How is this risk changing for your company?
- Key Customers
 - Where do they go if they don't have you?
 - Do they come back?



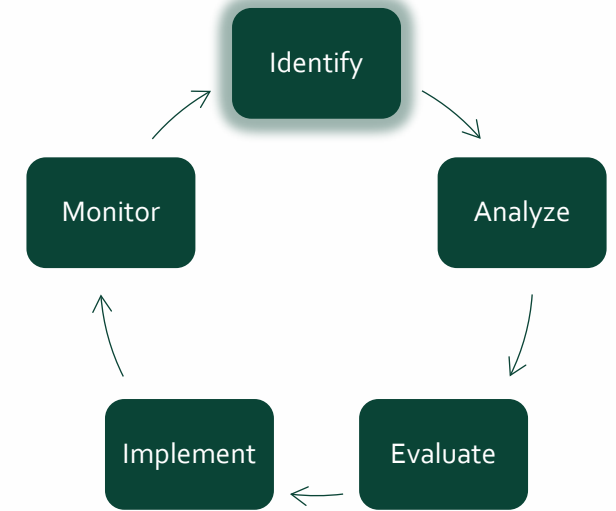
Do you know your vulnerability?

Cyber exposures are adapting and we are all at risk

Introducing Bob Miller, Director of Strategic Planning at Frank Miller Lumber Company

Financial

- Payment terms
 - Do your customers pay on time?
- Payment timing
 - Can you pay your debt obligations on time?
- Exports
 - Customs of doing business abroad
 - Do you have currency risk exposures?
- Market value fluctuation of goods sold

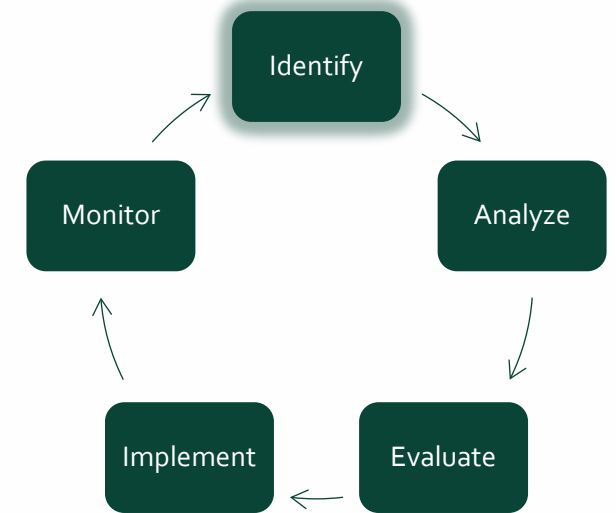


Strategic Approach to the Export Market

Introducing Hal Mitchell, President of Atlanta Hardwood Corporation

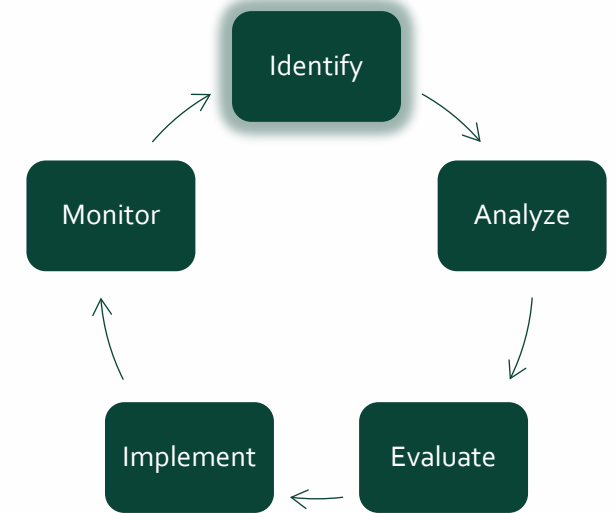
Strategic

- Product Viability
- Competition
 - Is your market share stable?
 - What are the barriers to entry for competitors?
- Social and Economic Trends
 - Do you know what your customers need?
 - Are you able to adapt?
- Capital Availability



Strategic

- Reputation affected by other risk exposures
 - Can you come back from it? How?
- Culture and Communication
 - Are all employees on the same page?
 - Do your business choices align with your mission and vision?
- Human and Customer Capital
 - Knowledge Transfer
 - Succession planning
 - Contingency planning
 - Legacy and future



Can your company withstand the unthinkable?

Introducing Pem Jenkins, President of Turn Bull Lumber Company



Risk is our
PAST, PRESENT, & FUTURE
and it deserves a seat at the table

Creating a successful ERM Program

- Risk should be a part of every conversation and every business decision
- Set the mission and objectives upfront and **communicate**
- Critical that an ERM program has buy-in at all levels in order to:
 - Identify and uncover risks as they emerge and evolve
 - Get attention of key decision makers for support
 - Push the mission and vision of the company forward
- Must be continually evolving
 - Risk evolves just as your business evolves

Emerging Risks

- Spotted Owl
- Tree Borer Beetle
- Long-Eared Bat
- Tax policy
- Government changes
- Weather

What is next?

EVERYDAY



THE AVERAGE HUMAN HAS

 **35,000**
OPPORTUNITIES

How are you going to move
your company forward?