

FAILURES OF RISK MANAGEMENT



for professionals
since 1941

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Exclusivity
Ownership
Mutuality

RISKY WORDS



➤ Volatility

➤ Probability

➤ Uncertainty

➤ Gambling

➤ Dare

➤ Trust

➤ Danger

➤ Surprise

➤ Predictable

➤ Guarantee

➤ Warranty

➤ Hedge

➤ Surety

➤ Reserves

➤ Smoothing

➤ Certainty

➤ Opportunity

➤ Threat

➤ Chance

➤ Entrepreneur

➤ Hazard

➤ Irrational

➤ Insurance

“Safe as houses”

“Money in the Bank”

“Like Government Bonds”

“You can bank on that”

TIME:

-We can assess the present – reasonably well

-The past is largely known ??

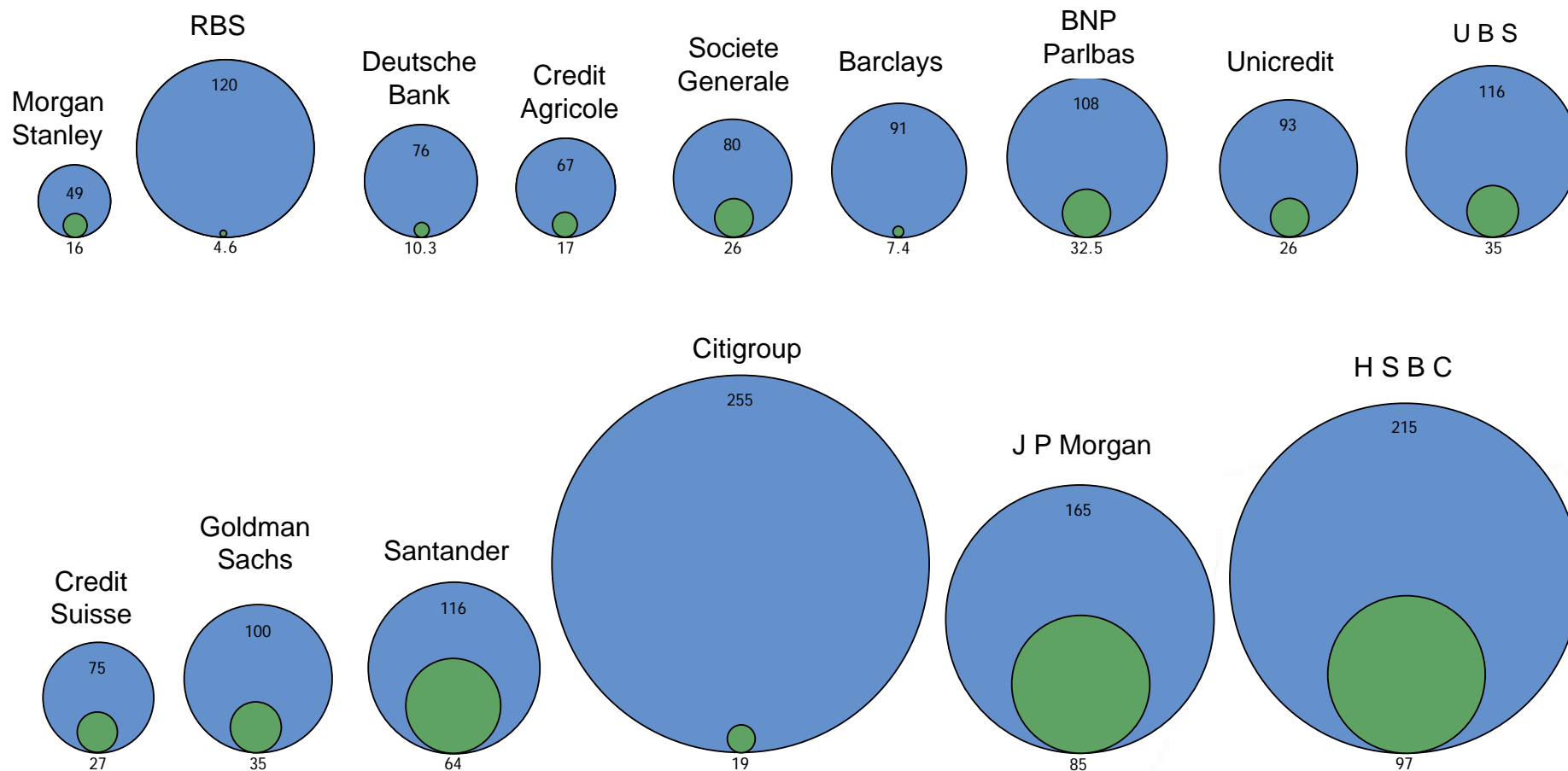
-The future is largely unknown

“TOO BIG TO FAIL?”



Banks: Market Cap

- Market Value as of January 20th 2009, \$Bn
- Market Value as of Q2 2007, \$Bn



While JPMorgan considers this information to be reliable, we cannot guarantee its accuracy or completeness

Source: Bloomberg, Jan 20th 2009

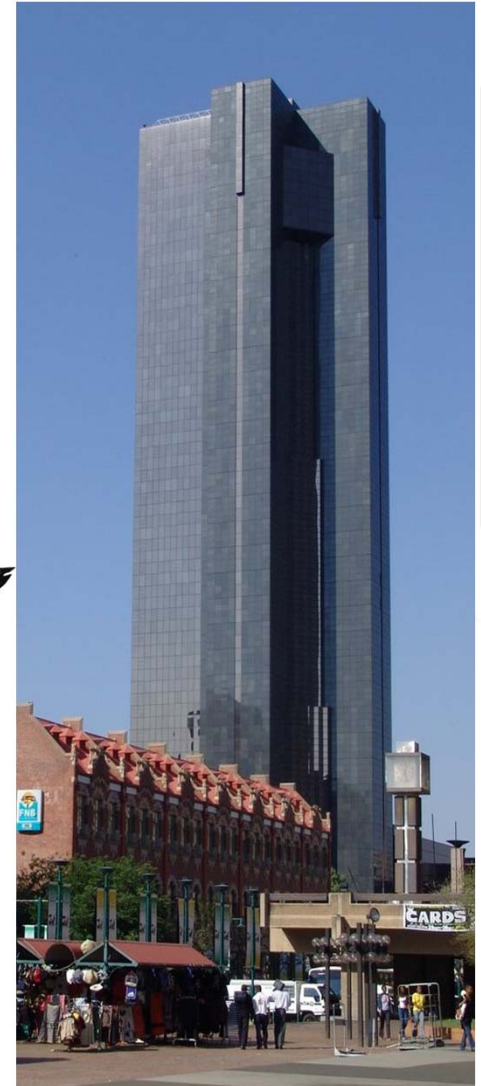
WHAT THE GLOBAL CRISIS HAS TAUGHT US



- **Countries have been spending money they don't have**
- **Democracy results in bad long-term decisions**
- **Profits blind us to Risks**
- **Boards will grill CEO's when Profits are down, show less concern when they are up.**
- **Too many Boards don't understand the business they are meant to be monitoring.**
- **Executive Remuneration is focused on short-term results.**



- **Shareholders are greedy for short-term results**
- **Regulators do not understand the risks**
- **Many Banks are “Too Big to Fail”**
- **Risk Sharing = Contagion ?**
- **Black Swans are everywhere**





BLACK SWAN

[Nassim Nicholas Taleb]



- An “outlier” – totally unexpected
- Extreme impact – e.g. 911, Sub-prime crisis, WW1, WW2, Tsunami, Icelandic Volcano, etc
- Retrospective explanation



“You don’t know what you don’t know”



RISKS



“NOTHING FAILS LIKE SUCCESS”

- The CEO should understand the risks : **Does he?**
- The Board should understand the risks : **Do they?**
- The shareholders should understand the risks: **Do they?**
- The Audit / Risk Committee should understand the risks: **Do they?**
- The Regulators should understand the risks: **Do they?**



KEY QUESTIONS:

-
- A background image showing several piggy banks (one pink, one white) and a large pile of various coins (copper, silver, gold) scattered around them.
- **How is this Company making it's profits?**
 - **Have different accounting methods "created" these profits?**
 - **Has this changed in the last 2-3 years?**
 - **How sustainable are these profits?**
 - **What are the dependencies?**
 - **How financially strong is this Company?**
 - **What happens if the No 1 client leaves?**

KEY QUESTIONS CONTINUED:

- **Can the Company survive 3 bad months? 6?**
 - **Is the CFO independent and financially astute?**
 - **What happens if the CEO resigns?**
 - **Are there any regulatory changes on the horizon?**
 - **What Black Swans would affect this business?**
- 
- A silhouette of a person in a suit walking on a tightrope, holding a balancing pole. The background is a light blue gradient with a white horizon line.

EXECUTIVE REMUNERATION

"YOU GET WHAT YOU PAY FOR"

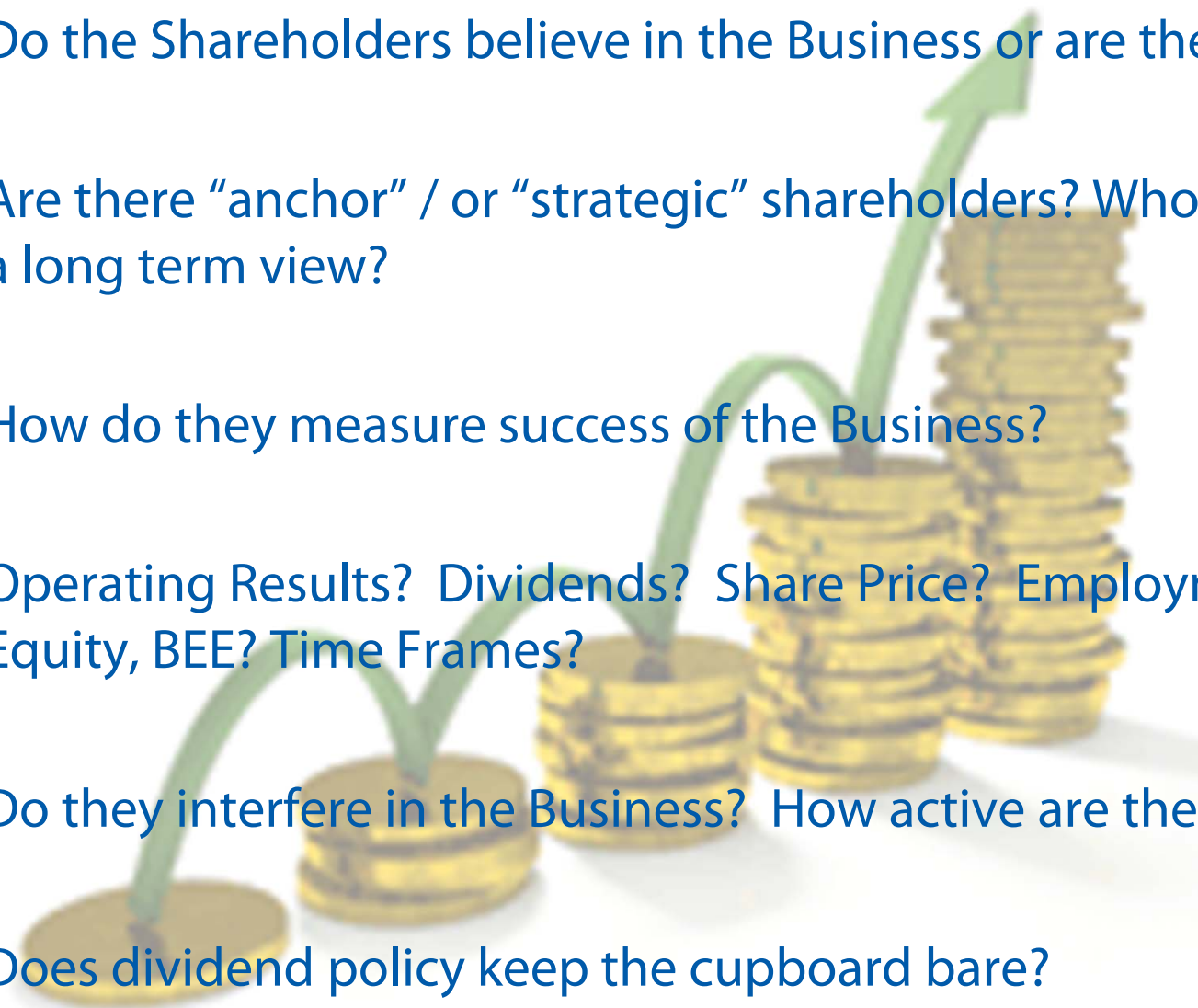
- **Are the key performance indicators (KPI's) agreed by the Board for the top team?**
- **Do they reflect the long term goals of the business?**
- **Is there a rigorous appraisal process in place?**
- **Do bonuses reflect long term as well as short term success?**
- **Are there "sustainability" goals?**
- **Do Executives behave as "owners" or "managers"?**
- **Are the Executives "conflicted" in any way?**





SHAREHOLDERS

- Do the Shareholders believe in the Business or are they Traders?
- Are there “anchor” / or “strategic” shareholders? Who will allow a long term view?
- How do they measure success of the Business?
- Operating Results? Dividends? Share Price? Employment Equity, BEE? Time Frames?
- Do they interfere in the Business? How active are they?
- Does dividend policy keep the cupboard bare?



REGULATORS / CENTRAL BANKS



- Caught napping by the crisis
- Focused on the wrong things eg: Freddie Mac and Fannie Mae
- Derivative structures – too complex – “Time Bombs”
[Merchant Bankers love complexity!]
- Focused on price inflation not asset inflation

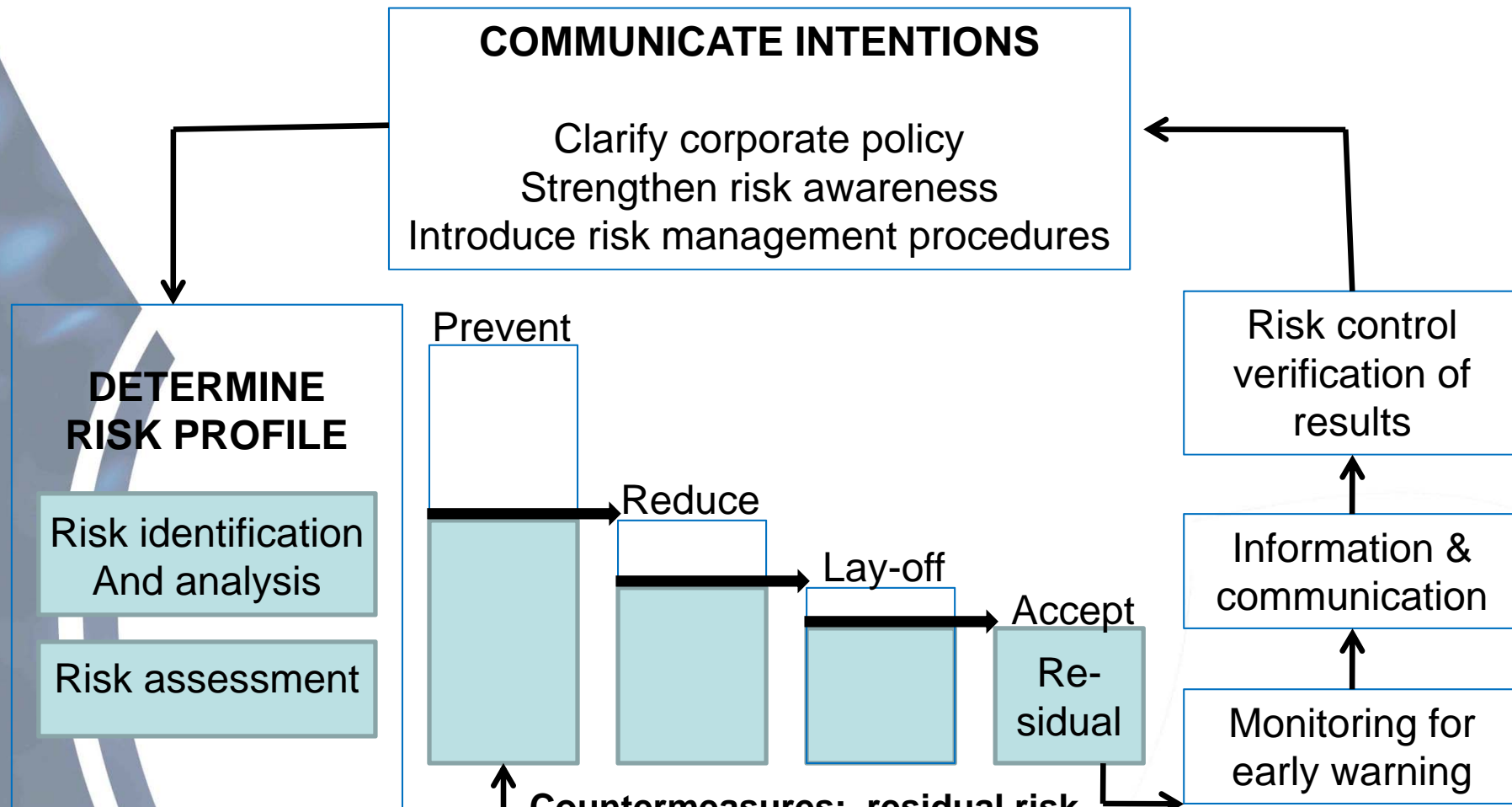


SOUTH AFRICA



- **Banking system strong = “Old Model”!**
- **Old Building Society (Mutual) model even better!**
- **National Credit Act – protected Banks from themselves**
- **Role of exchange controls**
- **Banks too big – lack of real competition**
- **When America sneezes!**
- **If China Falters ?**
- **Conservative Financial Policies have reduced Global Impact.**
- **Global Village not all good !**

RISK MANAGEMENT



- Countermeasures: residual risk**
- Define risk management strategies
 - Identify institutional collaborators
 - Allocate tasks based on relative effectiveness

Resilience to Risk
Sean Cleary
Thierry Malleret



Questions?