PANDEMIC BRIEFING

Risk Management implications of Coronavirus (COVID-19) – for Management

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Objective and Scope

This note is aimed at assisting actuaries in advising their employers and/or clients on the risk management implications of the COVID-19 pandemic.

As an actuary employed by a life insurer, general insurer, bank, health fund or superannuation fund, the health and economic implications of the pandemic will impact the organisation as a business as well as the customers of the business.

As a consulting actuary the implications will impact the consulting business itself as well as the clients of the business and their customers.

The implications for pricing, reserving, valuations, underwriting, and product design are not considered in this note as these are addressed in separate briefing notes for each practice area.

This note is complemented by the briefing note *Risk Management implications of Coronavirus (COVID-19) – for Non-Executive Directors.*

1. Introduction

In the face of the global response to the COVID-19 pandemic, businesses need to adapt to meet and balance the rapidly evolving requirements and expectations of all of its stakeholders, including customers, community, government, employees, regulators and shareholders/investors. For financial institutions there is, in addition, the disruption and volatility in financial markets to contend with.

Businesses also need to continue to provide their business-as-usual products and services, as well as protect the health and wellbeing of their workforces and the wider community.

The disciplined application of risk management frameworks can help businesses respond to these changes in a structured and prioritised way.

2. Back to basics

In such unprecedented circumstances it is tempting for businesses to immediately jump into action mode. However, although an immediate response may be needed to address some initial issues, it is also important to ensure that a structured approach is taken to managing the risks to the business. Businesses should keep front of mind that:

- Risks are anything that could cause a business to fail to meet its objectives.
- The Risk Management Framework (RMF) provides tools and techniques to assist businesses to identify their risks, understand their implications and determine appropriate responses and actions.
- Constituent elements of the RMF such the Risk Appetite Statement, Risk Management Strategy, Business Continuity and Pandemic Plans, IT Security Frameworks, and Key Risk Indicators (KRIs), will provide a solid starting point but may need to be adapted and updated for the current circumstances.

3. Business objectives

In response to the COVID-19 pandemic, the first questions for businesses to answer are:

- What are the business objectives?
- Have they changed?
- Are they different for the short, medium, and long term?

Aligning objectives and activities/responses to broader government signalling of lockdown levels (1/2/3/4) may help with communication of the business's response.

In the short-term, the objective for many businesses will be to quickly, effectively, and appropriately adapt to the changed circumstances so as to ensure their operational stability and financial survival, as well as maintain their customer franchise.

In the medium-term, objectives are likely to focus more on the achievable outputs and viability of the business during the on-going period of community and resulting business restrictions. A further objective might be planning for how to respond to a potential second wave of the virus.

In the longer-term, businesses will hope to revert to their pre-pandemic objectives but operating in a post COVID-19 environment, which may be somewhat different to pre 2020.

As the objectives will likely be different in the short medium and long term, so will the risks; a phased approach to managing risk will therefore need to be taken, assisting with prioritising and focussing on the critical business actions needed through each phase of the pandemic.

4. Risk Management

Having defined the revised objectives, the existing risk management tools can be applied to identify, assess, and treat the risks to these objectives.

Identification should:

- take a wide view – however daunting this might seem – as the COVID-19 scenario is complex, potentially impacting every objective of the organisation, strategically, operationally and financially;
- focus on consideration of what could go wrong; and
- also consider what must go right, as well as what could be done to increase the likelihood of successfully meeting the objectives.

Assessing the likelihood and potential impact of the inherent (untreated) risk on business objectives allows:

- the risks to be ranked and therefore prioritised for treatment; and
- recalibration of the acceptable level of risk (i.e. a re-setting of risk appetite and other risk limits for the different time horizons).

Treatment of the risks, to reduce their residual potential impact to within appetite, is achieved by:

- developing mitigating actions and controls where this is possible;
- where direct mitigation is limited, establishing KRIs with trigger levels that can be monitored and reported so that timely decisions can be made to manage the business' response to these risks if they are increasing towards unacceptable levels; and
- ensuring capital and liquidity adequacy relative to the risks identified.

5. Practical steps

Below are some practical steps that businesses can take, and questions that they should consider, in order to assess and manage their risks as part of their overall COVID-19 response. This list is by no means exhaustive but gives a "Top 10" to focus on.

i. Governance

- Convene a committee or task force that will be responsible for:
  - monitoring the evolving pandemic, government and regulator responses, and industry/peer actions;
  - engaging with Board, regulators, industry bodies and COVID-19 "think-tanks";
  - setting the business' response and coordinating agreed actions; and
  - communicating to the rest of the organisation.

ii. Business Continuity

- Use existing Business Continuity and/or specific Pandemic plans.
- Refine actions that require COVID-19 specific approaches (e.g. as a highly contagious virus, physical distancing is more important; high levels of staff absenteeism).
- Are BCP actions practically achievable? e.g. can current technology and technology security approaches support many employees working from home for an extended period?; if not, what other practical arrangements are needed?
- Focus on critical processes that need to be maintained or sped-up and how that can be achieved, including relaxing checks/controls on these processes, and slowing down/postponing less critical processes.
- Assess critical roles and prioritise resource allocations to these roles.
- Assess key person risk (older people, particularly males, are more susceptible) and succession planning (review risk to key successors); avoid physical proximity of key persons and successors as part of operating a team-based split workforce, with no physical interactions between the various teams.
- Actuaries who are holders of statutory roles (e.g. Appointed Actuary, Scheme Actuary) should be particularly mindful of the practicality of conducting and adequately covering these responsibilities during the pandemic.
- Regularly review and refine processes in response to employees testing positive for Covid-19, including managing employees they may have been in contact with.

- Consider how routine Covid-19 testing of employees could be adopted and its role in the workplace.

iii. Supply Chain (a subset of Business Continuity)

- Assess whether information/materials needed to operate can still be sourced.
- Assess viability of outsourcing arrangement, particularly those offshore where containment may be less effective than in Australia.
- Source alternative suppliers where needed.

iv. Workforce and community safety

- Assess how to enhance hygiene practices.
- Assess how to implement social distancing in all business interactions.
- Address anxiety concerns as well as health concerns.
- Review employee health insurance coverages.

v. Financial stability

- Identify key drivers of financial risk to the business and focus on the most critical (e.g., liquidity).
- Triage assets/investment and insurance/re-insurance/funding liabilities according to sectors of the economy that are expected to be highly/moderately/minimally/positively impacted by the pandemic.
- Assess baseline for the "survival horizon" of key assets/investments and liabilities such as sources of funding.
- Monitor customer behaviour in relation to optionality in products and take-up of support schemes.
- Review corporate insurance coverages.
- Review potential legal exposures. What legal exposures may arise from the way the pandemic has been handled?

vi. New/increased risks

- Damage to reputation and customer franchise
    - What is done for customers during the Covid-19 pandemic is likely to have a significant impact on the future reputation of the business and its customer franchise
    - Addressing customers' continuing needs, financial hardship and continuity of service (including in relation to pre-Covid-19 priorities such as recent bushfire and storm impacts) will be key

  - Short-term damage could arise from not meeting stakeholder expectations, as well as longer-term damage from meeting the immediate expectations which result in poor long-term outcomes for stakeholders, e.g., future claims of irresponsible lending
- As a result of steps taken to ensure business continuity and health/safety of the workforce and community, what non-financial risks have been increased or introduced? For example, risk of:
  - Successful cyber attack
  - Technology risks associated with backup and update processes
  - Fraud
  - Scams (against the business and its customers)
  - Financial crime
  - Physical asset risk
- Which business-as-usual processes are at greater risk of operational failures or weakened check and controls as a result of diverting resources to fight the COVID-19 battle?
  - Regulatory compliance
  - Business performance, regulatory and external reporting
  - Everyday maintenance activities (e.g., machinery failures, building maintenance)
- What steps are needed to manage these risks?
  - New compensating controls
  - New KRIs to know when further management action is needed
  - Temporary relaxation of checks/controls on less critical processes

vii. Financial projections and stress and scenario testing

- Re-calibrate internal base case and stress scenarios for current conditions (noting that the world is already in a stressed situation).
- Given the huge uncertainty in economic outlook and duration of the downturn, increase the number and range of scenarios modelled.
- Vary the duration and time increments of the forecasts to meet the need (e.g. shorter duration forecasts to explore potential liquidity issues).
- See separate Actuaries Institute note "PANDEMIC BRIEFING - Scenario and Stress Testing".

viii. **Frequency of application of Risk Management Framework activities**

- Risk assessments will need to be conducted much more frequently, dynamically and in a targeted way throughout the pandemic, particularly when material changes are made by governments to the community restrictions.
- Frequent reporting of the risk profile, as well as immediate escalation of control and limit breaches, to the COVID-19 committee/task force as the pandemic unfolds.

ix. **Communication**

- Ensure a two-way communication and consultation plan exists for the workforce, customers, regulators, and other stakeholders that reinforces the business' objectives during the COVID-19 pandemic.

x. **Potential knock on impacts**

- What risks might transpire in the aftermath of, and as a consequence of, COVID-19? (e.g., long term affordability of insurance, economic legacy of higher government debt including intergenerational impacts).
- What long-term changes to the way the world works, potentially contributed to by commissions of inquiry post the pandemic, could impact the current business model? What risks to the success/viability of the business, and what opportunities, are presented by:
  - structural change in some industries (e.g. health care)
  - changes in employment arrangements /industrial relations more broadly
  - behavioural and society attitude changes
  - post-pandemic traumatised or long-term impacted workforce

Reference sources:

"Applying risk management strategies to support health care in COVID-19" – MinterEllison (Donna Worthington, Dominique Fox) 16 April 2020 (https://www.minterellison.com/articles/risk-management-covid-19)

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"Managing Enterprise Risk and Compliance in a COVID-19 World" – Protecht Group

"COVID-19: Maintaining control" – KPMG, April 2020

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