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RISK MANAGEMENT

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How can CROs Add Value to the Investment Side?

Interview with Douglas Caldwell[+]

Chief Risk Officer and Chief Investment Officers have different perspectives. How can CROs and CIOs work more closely, especially in designing the risk management tools and metrics?

The CRO and CIO should have the same goal, which is to maximise risk adjusted return within the constraints of the risk appetite of the organisation. Thus, the most important point is to work towards mutual agreement on the risk/return metrics and risk appetite constraints. This requires developing a common view of the facts and a common language for discussion. Once this is done, each should be free to operate in their own space while collaborating where necessary.

In the current low interest rate environment, there is pressure for increasing yields by taking on additional risks? Should the CRO resist or enable? How would you approach this?

My view is that risk management is first and foremost about creating transparency and ensuring decisions are made within the proper governance structure of the organisation. It is not necessarily the CRO that needs to say yes or no if the proper environment for information and decision-making is ensured. The CRO of course can have a view and must enforce agreed limits, but the decisions can then be left to the investment professionals. This is certainly important in a time of low interest rates where one can generally only follow rates down and maintain asset risk profile or take more asset risk. The CRO can help make sure it is clear what decisions are being made and if they are supported by proper governance.

Do you see capital market hedging as a strict mechanical process to follow, or do you think it is beneficial to give leeway for hedging execution?

I believe the answer is yes and yes. I could also say that “it depends”. There are some hedging programmes, such as for variable annuity portfolios, where it is normally useful to be a strictly mechanical process. Where insurers have sold options that are highly volatile and risky, then a mechanical exercise aligned with an agreed risk profile is normally best. However, there are certain macro hedges and hedges at the margins of some portfolios where discretion may be best to allow for investment professional views. In all cases, the hedge programme and the level of discretion should be clearly approved in a hedging policy with appropriate limits.

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