Building a Performance-Focused Risk Management Process Step Two: Identifying Need

By Carol Williams

Volatility does not begin to describe the current environment with this year's COVID-19 pandemic, social unrest, economic instability, and ongoing P&C industry-specific challenges.

The first article in this series, published in the spring 2020 issue of The Demotech Difference, focused on the foundation P&C insurers must have in place to successfully develop tools for addressing challenges, adapting to change, and ensuring long-term success.

It is tempting for a P&C insurer to think they already have a handle on risk. After all, underwriters carefully examine risk to physical property when determining how much a policyholder needs to pay in premiums, and actuaries painstakingly determine the appropriate rates to be charged based on certain risk characteristics.

To successfully move from this traditional 'silo' approach to a more holistic enterprise-wide approach focused on performance and strategy, a company must have the right culture in place.

Risk in the context of company performance and success, though, is much different.

Insurance companies who are experiencing financial loss, the possibility of a ratings downgrade, or increased regulatory scrutiny, among other issues, typically resort to 'Band-Aid' fixes in a disjointed way with no connection to strategic objectives and other departments.

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Just as a house must have a solid foundation or else the entire structure will fail, P&C insurers who do not build a strong foundation of a risk-aware culture throughout the company will continue experiencing frustrating challenges. These challenges paralyze performance and could ultimately lead to insolvency and liquidation.

Although every company is different and therefore has its own unique needs, the previous article (TDD May 2020) outlined changes executives can start making now to build this foundation.

Once this cultural foundation is in place, the next step in this 'construction' process involves identifying and assessing the needs of the company, as this will ultimately drive an approach that makes sense for the company.

Many resources out there on ERM, including standards like ISO 31000 and COSO, take a one-size-fits-all approach that fails to account for a company's unique situation and needs. Simply copying and pasting these standards and guidelines yields a process that is bureaucratic, cumbersome, and hinders the company from building a competitive advantage. At worst, approaching risk management this way can exacerbate issues or even create new ones.

Therefore, identifying and assessing what the company needs for long-term success will help ensure risk management practices and processes will work for its

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Risk management is really just good management.

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While needs will ultimately vary from one company to the next, below are some common scenarios that prompt P&C insurers to improve their risk management practices.

Need #1 — Startup company experiencing fast growth

Companies who fall into this bucket typically have urgent issues that require attention, such as losing money without understanding why, reinsurance rates doubling from one year to the next, constant probing from regulators, or the company plagued by lawsuits. The source of the problem isn't really clear, much less how to fix it.

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When a P&C insurer is first being established, the primary focus of executives is simply getting things off the ground. After all, there are a lot of moving parts ranging from licensing to raising capital, obtaining reinsurance, and let's not forget, writing policies.

As the company grows, it becomes increasingly clear that managing things on a case-by-case basis is no longer feasible. Now everything is getting complicated: more than just a handful of people to manage, vendor contracts multiplying, systems being implemented, etc. Keeping up with it all through rudimentary techniques creates new risks around finances, compliance, reputation, or policyholder issues that can threaten future growth.

At this point, executives have to begin shifting their mindset from that of a startup to understanding what governance structure is needed to ensure processes are managed appropriately and are efficient and effective without being stifling or bureaucratic.

A P&C company may not have policies on how employees are reimbursed for expenses, no standard ways to manage and oversee vendors and contracts, no written strategic plan, and may even struggle with communication and collaboration between departments. In cases like this, the only way to know which vendors are being paid may be asking the accounting department!

Jumping into risk management without addressing these critical needs first will ultimately lead to failure for a variety of reasons. If there is no strategic plan, how will executives know how risks are affecting the company's success? If roles and responsibilities are not clearly defined, how will the company be able to hold executives and managers accountable? If there is no clear communication between different departments and layers within the company, how will leadership know how risk, opportunities, projects, and initiatives fit into the bigger picture?

Instead of addressing corporate governance issues through ad hoc policies, executives should take a step back and discuss what they are currently doing, try to understand what they should be doing, and who should be involved. Prioritize urgent issues then build on those.

Need #2 — Company now meeting regulatory threshold for reporting risks

Another common need or scenario that will drive a P&C insurer's approach to risk management is regulatory thresholds such as Own Risk and Solvency Assessment (ORSA). In this case, the company has grown to a point that it now must disclose risk information to its state's insurance regulator and, if publicly traded, the SEC.

Regulators' main concern is ensuring the company understands its biggest risks and that the appropriate steps to address them are being taken. Is the company solvent, in compliance with relevant laws, and consumer friendly? By the nature of their work, regulators are going to approach risk management with an audit mindset focused on whether the company is taking too much risk.

As you should be able to tell, regulators are taking a very risk-centric, negative view as opposed to one focused on the company achieving its potential.

Many companies, though, fall into the trap of providing a list to regulators and then shelving the information until the next year. SEC filings are notoriously generic; absent a few minor differences in word choice or structure, these reports share a lot of similarities. In this case, risk management becomes another 'check-the-box' compliance exercise and not a tool for helping the company succeed. Instead, the company should be incorporating risk information into its daily decision-making and processes, not simply reporting a list of risks to an outside party.

Another common struggle companies face is finding the right balance of what risk information to provide to a regulator. It would be impossible to identify every risk to the company, much less relay it to an outside party. And no company should try to actually reduce every

risk. Too much time, money, and people resources would be wasted, and the company would fail. To address this challenge, companies must understand the regulator's perspective and strike a good balance: share enough to satisfy the requirements without prompting additional questions, but do not share too much, as this will prompt even more questions.

A performance-focused risk management process in this context is about much more than creating a risk register and reporting the results to a regulator. Risk information should be continuously updated, monitored, and incorporated into decision-making.

Need #3 — Company recognizes it could be better

Companies falling into this bucket are by far the most mature in terms of their risk management processes but recognize there is always room for improvement.

They also do not necessarily have an urgent problem that needs to be handled or are experiencing financial stress. Perhaps the company's performance has 'plateaued' and its current approach is no longer working; after all, the environment, people, and needs of the company are constantly changing.

Executive leaders who recognize this need are forward-thinking and understand the world is changing at breakneck speed. As Hans Læssøe explains in his book "Decide to Succeed: Why and How to Apply Effective Decision Risk Management":

"The speed of change, the complexities and the uncertainties will only get worse as time passes. In this world, you can stand firm or learn to bend — it is a strategic choice."

One important point to remember is that improving risk management processes does not have to mean adding anything; often times, it is about streamlining processes.

Each company is different and therefore will begin its risk management journey from a different place. And the journey will be unique to each insurer.

Just because a company has a particular need in the present does not mean it will stay that way. Building a performance-focused risk management process means constantly reassessing needs and whether current practices are sufficient for meeting them, then determining the best approach to address those needs.

The first two critical steps to having a solid performance-focused risk management process are the cultural foundation and the different needs that will drive the approach a company takes to risk management. The next article in this series will explore ways P&C insurers can go about addressing these needs.

Which bucket do you fall into? Are you ready to start addressing your company's needs?

(Part 3 of this four part series will appear in the November issue of The Demotech Difference.)

Carol's career in insurance and risk management spans almost two decades, during which she has held a variety of positions as a Florida insurance regulator and industry expert. With over 10 years of hands-on experience in the ERM profession, Carol works with her clients to build sustainable ERM practices to support decision-making and strategic planning. Learn more at www.StrategicDecisionSolutions.com or email Carol@strategicdecisionsolutions.com.