Building a Performance-Focused Risk Management Process Requires a Strong Foundation

By Carol Williams

Today's insurance industry is more chaotic than ever. Nowhere is this more evident than the P&C market.

Challenges are not only different from what insurers had to overcome even as recently as a decade ago, but these challenges also create significant risks to success in this unpredictable industry. Escalating claim volumes caused by stronger, more frequent storms; dubious, widespread litigation; overall negative financial results and other market-specific risks are just a sampling of what insurers are facing in today's market.

Companies who fail to address these challenges face the threat of a ratings downgrade, which of course exacerbates these problems through higher reinsurance rates, increased regulatory scrutiny and more.

P&C insurers must therefore have tools in-hand for adapting to change and ensuring their long-term success.

Never has there been a time when P&C insurers needed tools for not only meeting these challenges, but for building a more resilient company that can confidently survive and thrive in tumultuous times. Let's face it — as the Greek philosopher Heraclitus reminds us, "The only thing that is constant is change."

Change, both professionally and personally, has always been a fact of life. What's different today is the pace of change — at no time has it ever been faster, and going forward it will only continue to be faster.

Consider the fact that when the telephone was invented in mid-1870s, it took nearly 70 years to grow to 100 million users. Facebook, on the other hand, achieved this milestone in just five years, and the popular game Candy Crush in just three. In years to come, companies could reach this milestone in under a year. Lemonade Insurance Company, for example, is pioneering the use of cutting-edge artificial intelligence and behavioral economics in the P&C market, which could lead to massive disruption in the industry, especially for companies who are targeting the same demographic.

It is hard to say with any specificity how events like the nascent cyber or "fourth" industrial revolution will impact regional and specialty carriers, but one thing is for certain. The potential for massive disruption is high. Companies who ignore this do so at their peril.

P&C insurers must therefore have tools in-hand for adapting to change and ensuring their long-term success.

Enterprise risk management (ERM) is a tool being adopted by executives like you to meet these challenges head-on. ERM is a tailored approach for proactively identifying, understanding, and responding to threats and opportunities while staying focused on company performance and objectives.

In his book "Risk Management in Plain English: A Guide for Executives," Norman Marks explains "… the more we are able to anticipate what might happen, the better we can be prepared and the better we will be able to respond."

Maybe you have heard of ERM, but like many insurance executives, have the perception that it is a bureaucratic exercise solely for satisfying regulators, auditors and rating agencies like Demotech. It can be easy to see why this view persists, considering ORSA and other risk management-related regulations that have come up in recent years.

This continued perception can be dangerous to a company's long-term success.

This article first appeared in the Spring 2020 issue of *The Demotech Difference*, a publication of Demotech, Inc., www.demotech.com.
To obtain your own copy contact BAlbert@demotech.com.

By the nature of their work, regulators have an audit-centered mindset, so they focus on the volume of risks and any documentation and controls. However, any company who tries to identify every single risk will just manage themselves right out of business.

Done the right way, ERM can help ensure your company's success and also provide a competitive advantage. No longer are you and everyone else constantly "putting out fires." Instead, you are making informed decisions focused on the pursuit of company goals. As you may suspect, doing this in a disciplined way dramatically increases the odds of meeting or even exceeding goals set during the strategic planning process.

Getting ERM to this point takes time, though. You cannot expect to go from nothing to a fully embedded process overnight.

Although the unique attributes of every company make it difficult to offer blanket advice, there are things you can do irrespective of structure, operations, or the markets you serve.

Despite all of the advice and resources out there, and risk management standards like ISO 31000 and COSO, many who establish ERM fail to realize any benefit because every company is unique. What works for one will likely not work for another.

Each company has its own culture and markets it serves. Every company will be unique in its structure and operations. Some companies may reinsure with affiliates, while others purchase this coverage from a separate entity. Other companies rely on a third party to handle claims, while others manage claims in-house.

These different variables make it difficult to point to any one method or process and say, "follow this and you will turn the company around in a year." Anyone who provides specific advice without knowing your company's details should be treated with extreme skepticism.

Although the unique attributes of every company make it difficult to offer blanket advice, there are things you can do irrespective of structure, operations, or the markets you serve.

One of the first places P&C executives can and should be taking a hard look at is company culture.

Any organization is going to manage risks to one extent or another … especially an insurance company. After all, risk management is what you do day in and day out. Insurance companies experiencing problems like poor vendor quality, high employee turnover, financial loss and the like often resort to "Band-Aid" fixes (like buying software or technology) that sometimes create other issues.

What often happens, though, is that risk management activities are 'disjointed' or ad-hoc with no rhyme or reason, and no connection to strategic objectives and other departments. In order to move from this traditional 'silo' approach to an enterprise approach focused on performance and objectives, risk has to become part of the day-to-day activities of the company.

In the end, the success of ERM will hinge on culture and, more specifically, the risk mindset of everyone from the most entry-level claims personnel to the CEO.

A few places you can begin making immediate changes in your company's culture are:

Tone at the top

A 2018 survey of risk professionals revealed leadership tone and lack of executive buy-in to be one of the biggest challenges to implementing ERM. The words and actions of executives always filter down throughout the company, so it is imperative that leadership is consistent and supportive in what they say and do. If employees are always getting mixed signals, the company will struggle to meet strategic goals, much less develop a fully embedded, success-driven ERM process.

Lead through collaboration

In past decades, executives would take a very heavy-handed approach to leadership, telling people what to do without considering feasibility or input from those who would actually be doing the work. This approach has led many to seek job opportunities elsewhere. To improve employee loyalty and company performance, executives should move away from this authoritarian approach toward a more collaborative one. Utilize the experience and knowledge of managers and support personnel by empowering and enabling them to make decisions (within a set of given parameters) and take action.

Adjust culture to reflect company growth

How things are done in a startup company is dramatically different from how they need to be done in a mid-sized firm. It is easy to know everyone when there are only 50 employees, but it becomes much more difficult when there are 300 or more. As a company becomes bigger, the CEO, you or other executive(s) should not try to verify everything that comes across your desks or know every single vendor contract, as an example. As a company grows, executives have to adjust their approach and processes to reflect this change.

Ensure clear and consistent communication

Although communication between executives, managers and employees occurs, many are not clear on what the company's goals are. To ensure everyone understands the company's goals and their individual roles in achieving them, there must be clear and consistent communication not just from the top down, but from the bottom up and between departments (i.e., both vertically and horizontally) as well.

Establish or clarify governance and internal policies

In order for ERM to be successful in the long-term, a company must have a structure in place for managing processes in an efficient, effective way. If there are not policies or procedures in place, or if objectives are not clear, then how can a company assess the risks of achieving these objectives or hold people accountable?

Hold people accountable

When it comes to deadlines and agreed-upon actions, there must be follow-through. Wins and accomplishments should be celebrated, but if a manager, employee or even a fellow executive does not meet expectations, they must be held to account. Consequences can vary based on the situation; it does not automatically mean they should be fired. However, if someone is not performing to expectations, or if there is a breach of trust, their responsibilities may need to be dialed back.

Building an effective ERM process that delivers helpful insights for decision-making takes time, patience, and some experimentation to find what works best for the company. Contrary to what some say, it can take time — a year or more — to go from nothing to a process that is embedded throughout all levels of the enterprise.

You cannot build a sturdy house without laying the foundation first. Without examining culture and making changes, starting with the tone at the top, ERM will languish and eventually be cast aside, and your company will be at a much higher risk of a credit ratings downgrade, financial loss, high employee turnover, reputation damage, or even dissolution or acquisition.

Are you going to continue to put your company at risk?

(Part 2 of this four part series will appear in the August 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.