THOUGHT LEADERSHIP

# RECOGNIZING AND REDUCING RISK DURING THE PLANNING PROCESS IN THE INSURANCE INDUSTRY

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## Overview

In the wake of the 2008-2009 Great Recession, the insurance industry, like all of financial services, is continuously searching for opportunities to recognize and reduce risk throughout all segments of their respective organizations. Risk management has become more prominent than ever as insurance organizations attempt to meet the increased regulatory scrutiny and requirements from the federal government. The planning process is a prime example where risk recognition and reduction is essential to achieve the goal of developing strong financials for strategic decision-making. What steps can you take to ensure that you are developing the best financial information to lead the company into the future? What procedures can you implement to help mitigate risk associated with all aspects of the planning process?

Unfortunately, the internal and external challenges facing the insurance industry continue to mount and are significant obstacles to consider and overcome. Representative examples are:

1. Investment income is earning historically low returns.
2. Commoditized product sets make it more challenging to distinguish your organic products from the competition.
3. Overall industry growth in product areas like life insurance and annuities is declining.
4. Pricing pressure for product premiums from the competition continues to rise.
5. Product and geographic diversification remain a priority.
6. Regulatory requirements add to the expense challenges.
7. Unforeseen reserve adjustments can impact your profitability.
8. Creating and maintaining cost efficient and productive distribution channels to aggressively pursue increased policy counts, an inherently difficult task, remains a top strategic priority.

Due to these constant pressures, rigorous planning and forecasting is vital to help chart the future direction of the company as well as help recognize and reduce risk during the entire process.

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As many people who are familiar with the planning process can attest, certain fundamentals will preside over any planning and forecasting process in the insurance industry. The process is always dynamic and involves many moving parts and personalities. Established planning policies and guides will always help facilitate the process. Budget transfer policies and annual planning guides are two examples of these planning documents that provide clarity on a wide range of planning steps. Business partner assistance is always welcomed and encouraged throughout the process. The planning process is sometimes contentious and not always equitable in the minds of the businesses; but strong planning and forecasting processes are essential to the development of sound financial numbers for strategic measurements and decision-making.

## Suggested Steps and Cadences in the Planning Process

A successful planning process is a year round endeavor in the insurance industry and includes the following suggested steps and cadences. Implementing these steps and cadences will ensure that a smooth planning process is executed and helps reduce the risk related to an improperly executed planning process.

1. **Establishing a planning calendar is critical to the process**. The calendar should be inclusive of all respective planning and forecasting cycles, system dependencies, and their interdependencies with the operating review and board meetings.

2. **Forming an Integrated Planning Committee with representatives from all business areas.** A collaborative planning environment is fostered by the regular interaction of these key planning team members, facilitating the healthy level of lateral planning that is critical to a successful planning evolution. Sample representation on this committee could be shown as follows:

    a. Sales /Telesales/Direct and Internet

    b. Underwriting

    c. Actuarial

    d. Finance

    e. Human Resources

    f. Office of the CEO

    g. Legal

    h. Internal Audit

    i. IT

    j. Risk

    k. Marketing

3. **Establishing effective communication across the organization.** Due to the number of people involved in the annual planning function, extensive communication is essential. Extensive communication includes regular meetings with the entire planning community and e-mails to the most current distribution lists. Members of the Integrated Planning Committee will play a key role. Other key partners will be the business finance officers, actuaries, and planning application coordinators.

4. **Coordinating with the planning application owners.** This has to occur to ensure the monthly and annual maintenance procedures and schedules are aligned with the periodic deliverables for monthly, quarterly, and board reporting. Business rules and allocations in your planning system need to be updated and maintained to reflect the latest changes in the businesses and the allocation drivers.

5. **Prioritizing strategic spend requests within each of the businesses.** Prioritization is essential to evaluating and determining those requests that will contribute the greatest revenue increase/expense

reduction/productivity increase/regulatory benefits/other benefits for the organization. The evaluation process for a limited pool of strategic spend dollars should include the following:

a. Development of comprehensive business case templates.

b. Extensive training on the proper completion of the business case templates.

c. Completion of comprehensive business case templates.

d. Lateral planning is performed and sign off with the other impacted businesses is conducted.

e. Rigorous screening process of the business cases before the presentation to the executive management team for approval is performed.

f. Executive management team meets in a timely manner to make the final strategic spend funding decisions.

g. Detailed tracking of the strategic spend grants is performed on the project statuses, expense consumption and the respective delivered benefits. Claw back of funding grants should be considered if promised benefits are in jeopardy or if project budget issues persist.

## Suggested Timelines and Views in the Planning Process

Multi-year planning views for revenues and expenses are suggested. A three year view is a good starting point for a multi-year cadence. If you utilize a long term planning application, the three year view can supply the financial foundation for your longer term view. As part of the cadence for a standard multi-year planning process, the following guidelines are suggested, assuming a fiscal year of January to December.

1. Early July – Review of the "business as usual" numbers (BAU) with potential adjustment of the multi-year targets based on business reprioritization since the end of the previous planning period.

2. Mid-August – Issuing of three year guidance to the businesses.

3. Late August – Submission of strategic spend requests.

4. Early October – Issuing of three year targets to the businesses with the inclusion of the strategic spend approvals.

5. Planning application open for entries in October, November, December and January – Schedule and dependency considerations incorporated into the opening and closing schedules.

6. December – Board review and approval.

7. Mid-January – Final planning refinements and details entered systematically.

Rigid adherence to a planning calendar will ensure the multi-year plan is completed on-time for approval by the board.

## What Questions Need to be Answered?

When all of the hard work is over and the multi-year planning numbers are ready for dissemination there are several key questions to consider when transitioning from an information provider to a strategic partner.

1. What positive and negative overall trends are tracked in the respective near and long term planning models?

2. How do your planning models help support and shape your strategy? Are you on course to achieve your strategic objectives? Are you exceeding your financial goals? Where do pressures and challenges still exist?

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3. Have you properly planned future reserves for Loss Planning related to Incurred But Not Reported (IBNR) losses and potential catastrophes?

4. Do the following projected KPI's meet or exceed your goals?

   a. Net Earned Premiums

   b. Risk-based Capital (RBC) Ratios by Insurance Line

   c. Best's Capital Adequacy Ratio (BCAR)

   d. Results of Operations

   e. Net Income

   f. Key Ratios

      - Loss Ratio Base %
      - Underwriting Expense Ratio %
      - Commissions Ratio Base %
      - Combined Ratio %

5. How do you effectively remain on a continued growth trajectory for the sales volume of premiums and policies (with internal investments and/or capital expenditures)?

6. How do you control expense levels (direct and allocated) to help price your products competitively? How do your projected annual premiums by product compare to the competition based on current trends?

7. Should you consider a joint venture or acquisition or continue to drive organic growth for expansion?

8. How do you leverage the stability and strength of strong insurance ratings (if applicable) in the sales process? Could it be worth touting the increased premium cost over the competition for the higher rating?

Considering and answering these questions are the final steps in mitigating any risks associated with the planning process in the insurance industry. Through these steps you can become much more than an information provider in your respective organization.

## ABOUT THE AUTHOR

**Joe Mizerak**, Director

Joe has over twenty years of experience advising, managing, and implementing financial planning and profitability solutions primarily utilizing Oracle's Enterprise Performance Management (Hyperion) and Business Intelligence suites. His experience and expertise includes the implementation of Hyperion Strategic Finance and Hyperion Planning applications at TIIAA-CREF and multiple profitability solutions across a wide variety of industries. These industries include retail and transportation with a primary focus in financial services and the insurance industry.

## Summary

The insurance industry will continue to face numerous growth and profitability challenges in the upcoming years. Risk recognition and reduction throughout the planning process is critical to ensure that the finest financial projections are developed. Established multi-year planning cadences will guarantee that the most accurate financial projections are developed to support sound strategic decision-making; allowing you to ask the right questions and answer those same questions as you migrate from a financial information provider to a trusted strategic partner within the organization.

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