Integrating Risk and Capital Management into Strategy and Planning
Key to Assessing Risk and Reward for Insurers
Tough Times for Insurers

Many insurance company board members face the challenge of satisfying the competing interests of various stakeholders such as investors, policyholders and regulators.

Insurers are called upon to increase premium growth, accept more and more risk, provide innovative products, price more competitively, offer differentiated services to policyholders, and maintain a suitable solvency surplus while improving both financial and economic profitability and, ultimately, delivering a higher share price or equivalent measure of success.

While profitability challenges are difficult enough, the economic climate of low growth, low interest rates and equity market volatility can make managing business performance more complex. This is further complicated by regulation becoming more and more pervasive, with the impact of new regulations affecting not only the boardroom but every part of the organization, from sales and underwriting to support functions such as finance, actuarial and risk management. And the direction of regulation appears clear—more regulation, more complex, and reliant upon defined rules forcing insurers to provide transparent evidence of compliance.

In this environment, insurers can benefit from making better use of the tools at their disposal to help evaluate the risk and reward trade-off when defining strategy, evaluating options and the balance sheet implication, assessing and setting risk appetite and allocating scarce resources by legal entity. Using the right tools to make strategic decisions can demonstrate effective corporate governance with a clear audit trail as well as meet regulatory requirements such as the Own Risk and Solvency Assessment.
Integrating the Own Risk and Solvency Assessment (ORSA) with Business Planning

ORSA is the heart of the Solvency II Directive.

Whilst implementation of the Directive may be subject to delay, some countries within the European Union have signalled a willingness to accelerate implementation of the ORSA requirement. There has also been significant interest from regulators, trade groups and insurers outside of the European Union, with regulators in the United States, Bermuda, Japan, China and Switzerland all considering the introduction of requirements similar to that of the ORSA.

The ORSA should not be viewed by insurers as a new static regulatory requirement for compliance; rather, it should be seen as an opportunity to integrate a number of existing considerations, activities, tools and outcomes, to enhance both the board’s and management’s ability to make improved strategic decisions.

For many, getting to this stage will require a major shift. No longer will premium growth and financial profitability be modeled in isolation from supporting capital and solvency requirements. Instead risk, capital management and solvency will be considered in the context of setting strategy and defining a business plan. Once growth, profitability and capital have been understood the output should not be seen as static deterministic output; rather, risk and volatility can be evaluated in terms of the potential impact on growth, profitability and capital objectives.

This approach we refer to as Integrated Planning. It integrates business planning with the ORSA and requires the alignment of strategy, business and financial planning, capital management, risk and capital modeling, solvency assessment and stress and scenario analysis across business units, countries, lines of business, legal entities and functional areas. Establishing such alignment can be a real challenge, even for insurers with mature capabilities, as it typically requires operating across traditionally siloed functions while employing the full breadth of risk and capital management, actuarial and financial reporting tools in pursuit of shared objectives.
There are Many Disparate Elements in an Integrated Planning Solution

Insurers have a number of different elements that play a role in an Integrated Planning solution.

These elements, however, can require significant re-alignment to deliver the value that a true Integrated Planning capability can offer. These different elements include strategy, business planning, financial planning, strategic asset allocation, capital management, solvency assessment, risk management, reserving, performance analysis and financial reporting.

Typically, each of these elements has a different business sponsor, with activity conducted by a different business function at different times of the year. This can create output in varied formats that do not reconcile to other outputs due to inconsistent use of methods, parameters, time horizons and reporting tools.

One challenge is to re-align these parts so that they produce consistent and common output that contributes to an Integrated Plan. The Integrated Plan is the output that aligns the interests of different external stakeholders and is approved by the board. While the relevant output outlined in Figure 1 below is not exhaustive, it indicates that there are many highly complex components that are dependent on each other and required for an Integrated Plan.

An immediate priority for many insurers is to make an Integrated Plan central to how the business is managed while verifying whether the content of the plan is defined in a consistent manner.

Figure 1: Business outputs used to develop an Integrated Plan

<table>
<thead>
<tr>
<th>Element</th>
<th>Owner</th>
<th>Function</th>
<th>Relevant Output for an Integrated Plan</th>
</tr>
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<tbody>
<tr>
<td>Strategy</td>
<td>CEO</td>
<td>Strategy &amp; Planning</td>
<td>Strategy Key Performance Targets</td>
</tr>
<tr>
<td>Business Planning</td>
<td>COO</td>
<td>Strategy &amp; Planning</td>
<td>Business Plan and Operational Metrics Strategic Initiatives and Investment</td>
</tr>
<tr>
<td>Financial Planning</td>
<td>CFO</td>
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<td>Financial Plan Financial Metrics</td>
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<tr>
<td>Strategic Asset Allocation</td>
<td>CIO</td>
<td>Asset Management</td>
<td>Investment Risk Appetite Asset Allocation</td>
</tr>
<tr>
<td>Capital Management</td>
<td>CFO</td>
<td>Capital Management</td>
<td>Balance Sheet and Reinsurance Structure Economic Capital and Dividend Policy</td>
</tr>
<tr>
<td>Solvency Assessment</td>
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<td>Solvency Capital Requirement Regulatory Reporting</td>
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<tr>
<td>Risk Management</td>
<td>CRO</td>
<td>Risk Management</td>
<td>Risk Appetite Risk Aggregation and Assessment</td>
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<tr>
<td>Reserving</td>
<td>Chief Actuary</td>
<td>Actuarial</td>
<td>Technical Provisions Loss Ratios Experience Analysis</td>
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<tr>
<td>Performance Analysis</td>
<td>CFO</td>
<td>Financial Planning &amp; Analysis</td>
<td>Management Information Reporting</td>
</tr>
</tbody>
</table>

Source: Accenture
Content of an Integrated Plan

As discussed, there are many aspects to an Integrated Plan.

At the core, insurers may want to consider an approach based on five distinct and related sections. These five sections are Strategy, Planning, Capital Management, Risk Assessment and Reporting (see Figure 2).

Source: Accenture
Strategy: The objective of the Strategy section is to clearly set out the medium- to longer-term value proposition for shareholders, or policyholders for a mutual insurer, and subject to their agreement, to ensure the value proposition is used to provide strategic direction and align internal activity.

Included within the shareholder value proposition is a clear articulation of the insurer’s strategy including its target market, customer segments, core products and preferred distribution channels, along with a select number of relevant key performance targets such as return on equity and growth in regulatory surplus. Historically an articulation of strategy is made with a positive expectation and firms need to start to align this with a well-articulated risk appetite statement that considers the volatility in earnings associated with the strategy and the implication for a stable dividend policy.

Planning: A good Planning section builds on the direction set by the Strategy section and introduces greater detail and specificity over the medium term by defining strategic initiatives and the investment allocated to each activity. A financial plan including financial metrics, the setting of an investment risk appetite and identification of the preferred asset allocation strategy are also central elements of the Planning section. For the Planning section to be of day-to-day relevance to the business it may need a sufficient level of detail to guide decision making in a manner that is consistent with strategy and the associated risk appetite.

Capital Management: Given the current economic climate and the volatility in the financial markets, effective capital planning can be part of the development of an Integrated Plan. The capital management section of the plan defines the economic and solvency capital requirements, summarizes the balance sheet including associated technical provisions, and outlines the reinsurance arrangements for achieving the articulated strategy. Capital projections for the medium term horizon can verify whether they exceed the projected solvency requirement while being optimized to deliver the required return on equity and stated distribution to shareholders. Consideration of funding sources can also be undertaken and documented with a number of factors evaluated including cost, depth of market, liquidity and risk.

Illustrative questions to be answered include: If we use more reinsurance what are the implications for profitability, capital requirements and return on equity; how should outwards reinsurance be structured between proportional and non-proportional and split between internal and external; or if we increase our debt funding then how does this restrict our free cash flow and ability to pay a dividend?

Risk Assessment: Frequently, when strategy and planning information is presented, it represents a baseline towards which the business works. It does not, however, specifically consider risk, and this is where the Chief Risk Officer (CRO) plays an important role. The CRO and the Risk Management function can actively challenge the baseline Integrated Plan and use clearly defined scenario and stress events—possibly including reverse stress tests—to understand how robust the plan is. The stressed events that are assessed can include “unthinkable” tail events across the breadth of the business and the full risk universe, with the impact on projected capital in the Capital Management section fully understood.

This is the essence of the ORSA proposed under Solvency II. In going through the ORSA process, the Risk Management function can help shareholders, the board and senior management understand how achievable and robust the firm’s value proposition to shareholders really is and inform the determination of the solvency capital requirement as well as other capital measures.

Reporting: Finally, the reporting requirements for insurers continue to grow and become even more complex. This makes having reconcilable views under different reporting bases an important part of an Integrated Plan and supports the ease with which investors and other stakeholders can be engaged. Core statements for inclusion in the Integrated Plan include a technical account, profit and loss account, balance sheet and cash flow, all of which can be prepared on a number of different bases including multiple GAAP, regulatory and internal, for the consolidated group and individual legal entities, with reconciliation performed and explained in a transparent manner that can maintain stakeholder confidence.
Using Technology to Assess the Risk/Reward Trade-off

When discussing the concept of an Integrated Plan with CFOs and CROs, the conversation often moves quickly to the issue of technology.

These executives frequently see their technology environment as highly fragmented and unable to provide the data or output needed for analysis. Very often this leads to the use of manual processes with poor controls and results in fragmentation across the group rather than a set of integrated activities for undertaking diligent planning.

This is an understandable reaction to an underlying technology environment that may include the use of different tools to model different risk components including market risk, credit risk, operational risk and insurance risk including aggregation. These tools may be supplemented with an economic capital aggregator, reserving system, investment system, data stores for policy and claims data, local databases and spreadsheets, general ledger and a financial planning application, with each system producing output based on opaque parameters defined by system users, and with matters further complicated by the use of unstructured data and the presentation of results in unstructured formats.

For a global insurance group operating in both the life and property and casualty sectors, this immense complexity can be a significant barrier to running a co-ordinated planning process that considers the risk reward trade off when making strategic decisions.

Whilst insurers have made significant investments in standardizing and simplifying their finance and risk technology environment in order to comply with regulatory requirements, there is still significant work required to achieve further benefit. Specifically, there are four technology areas for insurers to focus on: implementation of a consistent global enterprise planning application; integration of the planning application into the existing finance and risk architecture, integration of performance, financial and risk reporting, and continued standardization and centralization of data including data quality assurance.

Today many insurers still adopt a spreadsheet based approach to capturing planning information with the associated process to collate all of the input highly manual, time intensive and often lacking in demonstrable control. Implementing a global planning application represents a significant improvement in capability for many and even in situations where an insurer has implemented such a tool it is often not used to its potential. The use of such an application can enable the integration of group level planning, budgeting and forecasting information with consistent drill down to business units, legal entities, countries and lines of business. The application can provide the added benefit of a central repository for all of the elements covered by an Integrated Plan with changes subject to a clear audit trail.

Insurers that integrate the planning application into the existing finance and risk architecture can yield further benefit as risk and capital information critical to business decision making is incorporated into the traditional planning output (see Figure 3). This means, that along with traditional planning information such as premiums, expenses and projected financial profit, there can be information on the corresponding solvency requirement, regulatory balance sheet and relevant key risk metrics such as expected aggregated loss for specified events based on the planned portfolio.

Integration of the planning application into the finance and risk architecture further can help align performance and risk reporting with external financial reporting, to aid the board and senior management evaluate the performance of the company.

Data availability and data quality typically remain a challenge. Implementation of specific applications or broader development of the finance and risk architecture across the enterprise needs to be mirrored by parallel improvements in the storage of information in a consistent format with the requisite controls to ensure the improvement in data quality over time.

Figure 3: Integrated Architecture

![Diagram of Integrated Architecture](image-url)
Critical Success Factors for Delivering an Integrated Plan

The production of an Integrated Plan is a complex activity typically dependent on multiple critical success factors, including sponsorship, consistent segmentation and a clearly defined process.

Typically the appointed senior executive is the Chief Financial Officer or the Chief Operating Officer, however, due consideration should be given to the Chief Risk Officer, with a key factor being their ability to evaluate the risk reward trade-off options as articulated within the Integrated Plan in an insightful and impartial manner, and to follow up by fostering increased collaboration across geographies, legal entities and functional areas.

Implementing a consistent segmentation of the insurance group can standardize the way in which performance is reviewed, while creating the flexibility to meet differing requirements. A typical minimum standard hierarchy for segmentation includes group, legal entity, region, country, line of business and product, with the need to focus on planning for the legal entity a requirement for regulation in certain jurisdictions. Adopting a consistent hierarchy can provide the platform for undertaking detailed technical and financial planning supported by an understanding of both the asset and liability implications.

Laying out a clearly articulated integrated planning process—one that produces defined, appropriate and consistent output in line with a managed timetable—is another important factor for success. It is often simpler and more effective to understand how existing processes contribute to Integrated Planning with some re-alignment as required rather than to design and implement a new process from scratch. By doing this, existing process owners are typically encouraged to contribute rather than feeling that a new process is being imposed upon them. The refined process and timetable can align to the communication needs of both investors and regulators, and allow for significant internal iteration as business assumptions are modeled to inform the setting of risk appetite, understanding of economic capital and solvency constraints and to verify whether overall planned performance is in line with group strategy and investor expectations.
There are a number of significant benefits associated with implementing an Integrated Planning approach, with the potential benefits encompassing both qualitative and quantitative aspects.

The significant potential benefits for consideration include:

**Alignment** of strategy, risk taking and risk management with an improved understanding of the risk reward trade-off as the basis for strategic decisions. For example, when the business is considering changing the business volume or mix, the implication for volatility of performance, risk appetite and solvency capital can be assessed together.

**Improved** allocation of capital to the areas of the business that achieve the preferred combination of growth, market penetration, projected return on equity and volatility. This, in turn, can lead to achievement of an enhanced return on equity.

**Strengthened** shareholder, regulatory and rating agency confidence supported by the provision of the full breadth of information required and with an emphasis on prospective and predictive information.

**Productive** collaboration between senior management and their functional areas of responsibility through an iterative approach to understanding the risk and reward of different options and agreement on the plan.

**Standardized** framework for assessing entry into new markets, products and distribution channels, or the acquisition of a portfolio, business or company.

**Attaining** "one version of the truth" with the plan guiding decisions across the business through different reconcilable views.

**Establishing** an agreed and transparent baseline against which individual contribution can be assessed and subsequently rewarded.

Effort can be made to quantify these benefits for inclusion within a business case that secures the required investment to transform planning from a fragmented, siloed and financial focused activity to one that comprehensively evaluates both risk and reward.
The path to high performance for Integrated Planning is often a multi-year journey that requires changes to governance, organization, process, data, systems and culture across the business.

There are numerous options for implementing these changes from “big bang” to evolution. In order to define the appropriate roadmap, an insurer should consider undertaking the following actions:

**Determining** the enterprise’s ambition level through facilitated workshops involving senior management and external stakeholders.

**Reaching** agreement on the key metrics for measuring and communicating performance such as solvency coverage ratio or return on equity.

**Outlining** the required planning timetable, considering group, business units and legal entities, as well as the frequency of reporting.

**Articulating** the required operating model to support the planning timetable and changes compared to the current state.

**Confirming** an information hierarchy encompassing group consolidation, legal entities, business units, countries, lines of business and products, with a supporting methodology for financial accounting, regulatory and internal calculation including reconciliation.
Accelerating the implementation of changes to the organization and corresponding roles and responsibilities.

Re-engineering the existing business processes including strategy setting, business planning, financial planning, capital modeling and risk management.

Iterative learning that can improve and optimize the Integrated Planning process and embed the process across the organization.

Data remediation that can aid in completeness, accuracy and timeliness of the data inputs for Integrated Planning.

Technology changes designed to store model parameters, automate the production of information, consolidate and centralize historical planning information and perform variance analysis.
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Accenture Risk Management consulting services work with clients to create and implement integrated risk management capabilities designed to gain higher economic returns, improve shareholder value and increase stakeholder confidence.

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