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A New Risk-Adjusted Operating Model for the Insurance Industry

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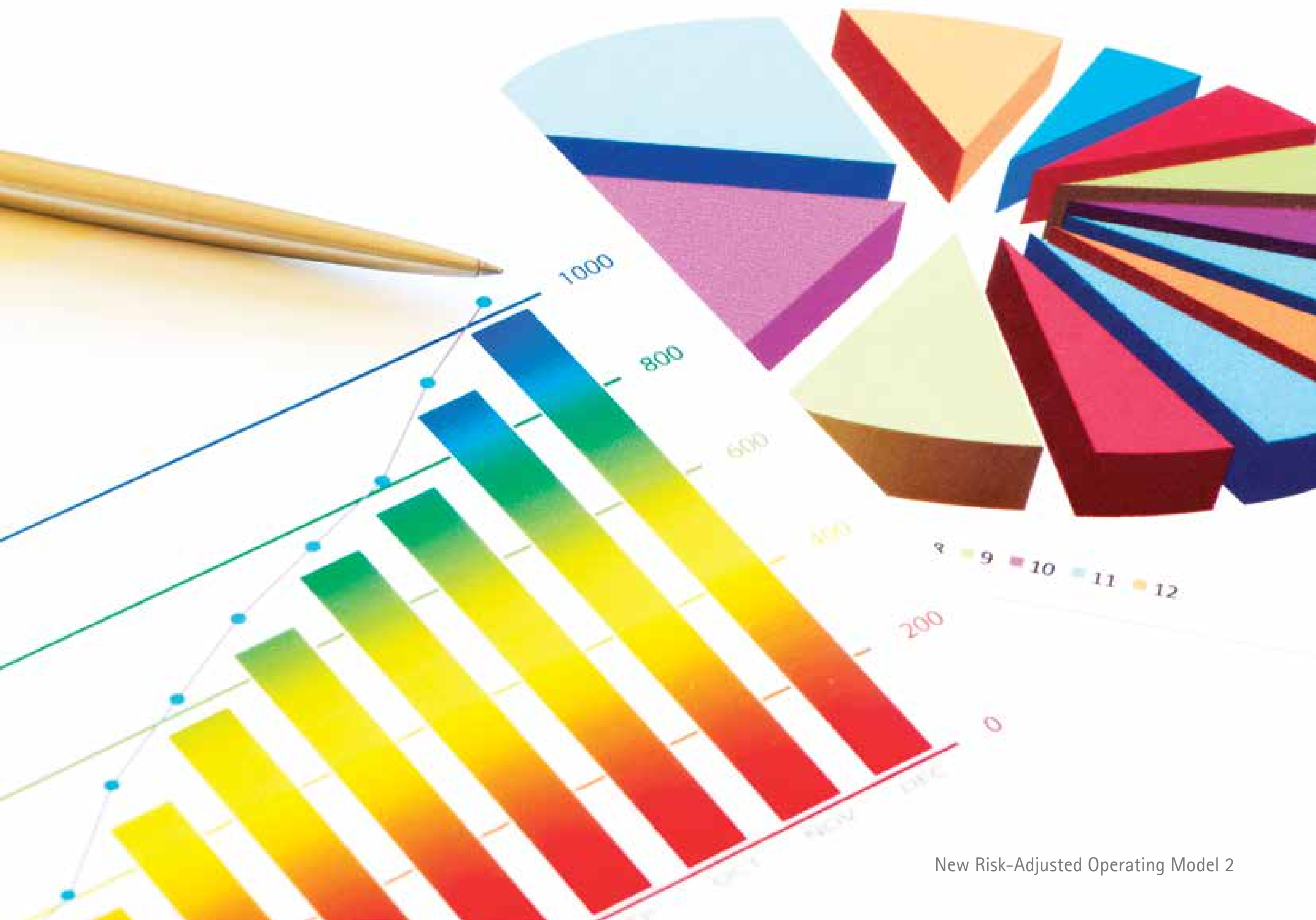
It has become clear - in the face of new regulatory and economic pressures – that insurers should increase their ability to make risk-based decisions by incorporating risk management into key business processes.

While compliance with regulatory requirements such as Solvency II in Europe is a major concern, insurers have begun to recognize that they need more than just compliance; rather, they should consider far-reaching, risk-focused business solutions to improve their competitive position.

Achieving full compliance through transformation of Enterprise Risk Management (ERM) functions will be a complex and costly undertaking, that may require extensive investment to support long-term, profitable growth. Accenture believes that, by aligning risk with overall strategy and integrating it into key business processes, this objective is supported most effectively. We have termed our approach the Accenture Risk-Adjusted Operating Model (RAOM), designed to help insurers improve their risk capabilities to generate additional value while reducing costs.



The New Challenges of Risk

Analysts, regulators and rating agencies are developing new guidelines and assessment criteria, including risk management capabilities and practices, in evaluating the soundness and integrity of insurers and the level of protection afforded to their policyholders.

Figure 1. Key challenges faced by risk management functions

Accenture 2011 Global Risk Study confirms that aligning risk with overall strategy and integrating it into key business processes while reducing costs are the key challenges for the risk organizations

Source: Accenture

Accenture's 2011 Global Risk Study – conducted with C-Level executives at 48 global insurers – indicated that insurers see improving risk measurement and modeling, reducing the cost of risk management compliance, and integrating risk and finance information and processes within the organization as the most significant challenges they face. The insurers also want to improve their risk capabilities in internal reporting, risk-adjusted performance management, and the integration of finance and risk. (Figure 1)

The new regulatory requirements increase costs related to risk management. In particular, insurers should consider improving their quantitative and qualitative risk management capabilities; reporting and public disclosure; data management; and overall risk governance. To meet regulatory demands, insurers should upgrade their data collection, analytics, and reporting capabilities.

The major driver of cost in risk management, however, is inconsistent execution of risk management in key business processes. The processes needed to identify, analyze, assess, report and respond to risks related to specific areas of responsibility are complex. Often, a consistent risk management framework – which should serve as the base for execution of risk management throughout the entire company – is not in place. This creates a situation in which individuals involved in different processes do not use the same standards and data for how to identify and assess risks, and how to respond to these risks once they are identified. A standardized, integrated approach to risk management for all business processes –avoiding duplicative processes and unnecessary activities — can help minimize the costs associated with inconsistent execution.

Integrating Risk into Key Business Processes

At many insurers, the organizational structure of the risk management function only supports ERM to minimize risks within a particular business process.

Without a company-wide integration of risk management, information used to assess risk in one core insurance process may not be available to assess other business opportunities from a risk/reward perspective.

New regulations increase the burden on insurers to provide complete and transparent documentation of all processes which bear risks. While this can pose a significant challenge to insurers, process documentation also provides an opportunity review the existing process landscape and can serve as a mechanism to remodel existing processes, or even design new ones.

A formal statement of risk appetite can provide a strategic direction for business decision-making. Such a statement can generate value by helping align strategic objectives with risk tolerances, preventing unwanted risk taking by operational units and fostering greater efficiency in the allocation of capital. The risk appetite statement also signals to stakeholders that the company has established clear boundaries for overall risk taking.

Developing a formal statement of risk appetite poses challenges of its own. Once the statement is formulated, it should be approved by all board members, and then promoted internally as guidance for the evaluation of business opportunities, risk assessment and resource allocation within the entire organization. In addition, the ongoing collaboration of risk management with front office, distribution, finance and operational functions should be supported by dedicated processes to ensure that all business takes place within the boundaries established by the risk appetite statement.

Similarly, risk management should be integrated into strategic planning to ensure that investments fully reflect the risks involved. This integration enables the company to balance risk and reward in considering available opportunities. Many companies lack the common risk vocabulary, the shared metrics and key performance and risk indicators (KPIs/KRIs) and the firm-wide access to data (along with centralized databases) needed to fully integrate risk and financial information.

Issues in Data Management

Within the insurance industry, the sophisticated models needed for effective risk management depend upon the availability of accurate and validated data, properly organized and delivered with the right level of detail and granularity.

Insurers with multiple back-end systems – or with information stored in silos that are not accessible to groups that may require it – face challenges in providing consistent, high-quality data to the risk management function. The main problem for insurers – once high-quality data is obtained -- is the definition and implementation of a framework for data management to support both consistency and quality of data throughout the organization.

Like data quality, data governance is very important for the effective management and use of information by multiple stakeholders within the company. When ownership of data is unclear, redundant data sources may be in use without clearly assigned responsibilities as to the manipulation, retention or deletion of data.

Comprehensive Technological Solutions

Many insurance companies operate with a fragmented risk architecture that fails to support the full use of risk management tools and models within the context of the overall business.

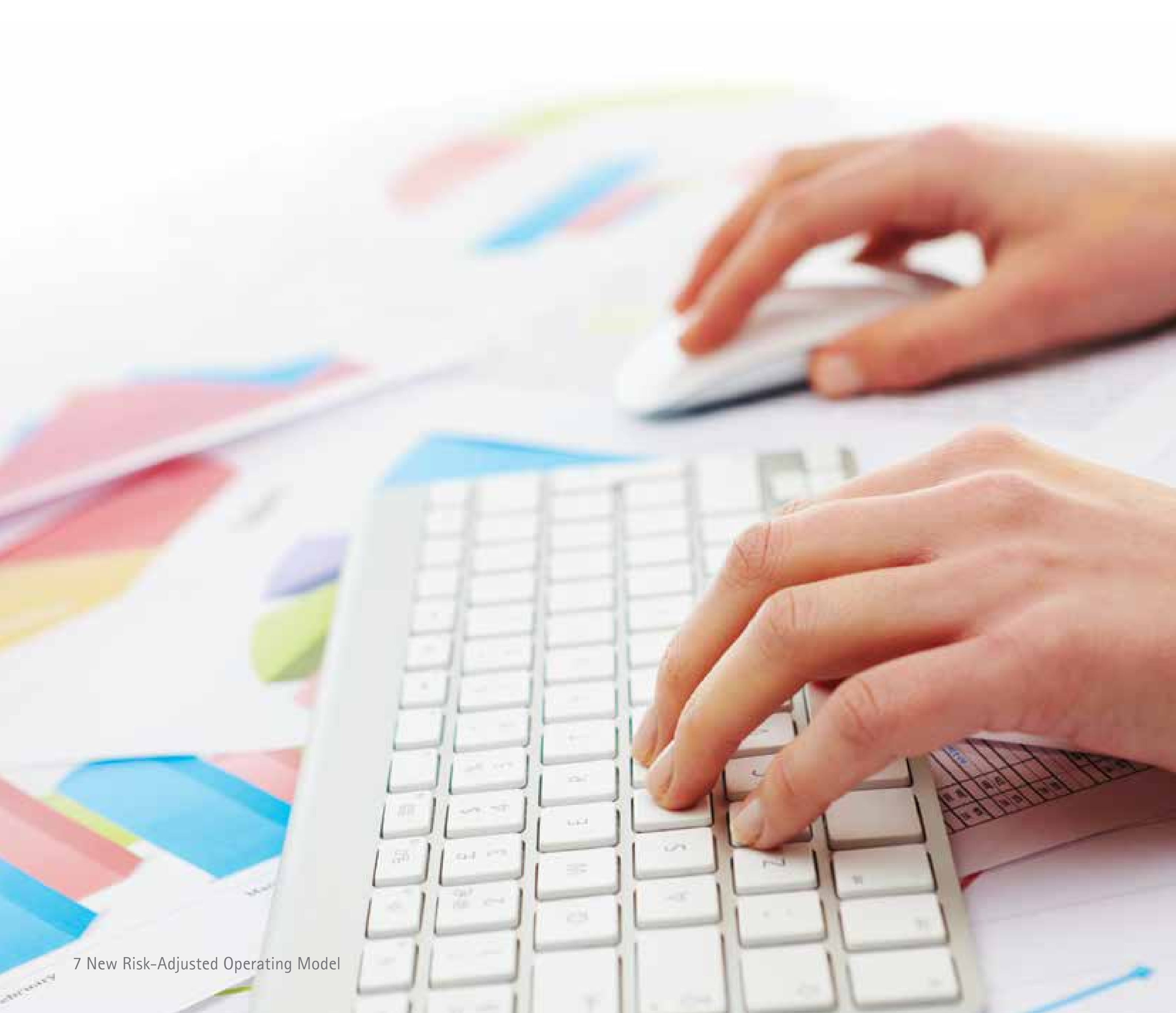
As a result, there is a lack of systems to provide an integrated view of risk. A comprehensive, uniform IT landscape – reflecting industry-specific reference architecture as a structure to enhance capabilities – is needed to support multiple functions and realize available synergies.

As they contemplate moving to a new risk adjusted operating model, insurers should keep in mind the complementary nature of the various elements involved in the transformation. For example, improvement and integration of IT architecture supports increased automation and makes it easier to provide robust IT support, which in turn helps to lower risk management costs.

II. The Changing Role of Enterprise Risk Management

The contribution of Enterprise Risk Management (ERM) is changing and growing as the information provided by risk management is used to support value generation.

For example, the Chief Operating Officer now takes advantage of risk management capabilities by integrating specific processes to support decision-making and value generation. While ERM has been primarily a compliance-driven function that protects the value of the enterprise, it is increasingly strategy-driven, with a main focus on maximizing and not just protecting enterprise value. The redesign of risk management as a source of competitive advantage is now one of the primary objectives of the insurance industry, with the potential to enable long-term profitable growth.



Changing regulatory regimes such as Solvency II set a high priority on actuarial and risk management capabilities. Under Solvency II, the actuarial and risk management functions have clear roles and responsibilities, which go far beyond standard activities such as risk identification and modeling. The impact of these functions within the organization and on decision-making processes is high.

There are a number of factors contributing to this development:

1. Ongoing market pressure

Greater economic volatility in the markets, accompanied by increased uncertainty, has generated pressure to improve risk management capabilities. Insurers are investing in more sophisticated risk analytics tools to improve the measurement of rare risk events that carry a high degree of severity for their portfolios. These tools help, for instance, to reduce underwriting risk, contributing to profitable and sustainable growth. Other companies may use sophisticated ERM to create competitive advantage, meaning that insurers might have to improve their ERM function to stay relevant in the market as other players use ERM for sales activities, to gain market share, for rating discussions, and other purposes.

2. Capital market innovations

New instruments such as mortality bonds, along with highly risky and/or complex assets such as hedge funds and venture capital, call for sophisticated risk management methods and tools to provide an accurate picture of risk. These methods and tools will not only help insurers manage their exposures more effectively, they will help them capitalize on opportunities, improve organizational performance and, ultimately, enhance long-term shareholder value.

3. Improved business results through integration of risk and core business processes

Overall risk management can be improved through the consideration of risk in the decision-making process. For example, an effective integration of risk-based capital methodologies in decision-making tool kits – requiring high data quality and a common metric system such as one based on economic capital – can weigh both the combined effects of risk-taking activity and the impact of such activity on economic value. With economic capital models, insurers can optimize capital allocation from a strategic risk vs. reward perspective, and gain a competitive advantage by leveraging ERM and economic capital modeling in their strategic decision-making process.

Another source of competitive advantage is the integration of risk and finance processes within core insurance processes. Most insurers have not linked risk and adequate pricing with sales but those who do can gain full use of risk-related information to support dedicated sales activities. These can then be tailored to client segments with a better perspective on potential risks and rewards.

The combination of risk-adjusted metrics, traditional asset and liability management, and profitability performance measurements provides the company with a more balanced view of business performance. Another benefit of integration is consistent data management between the risk and finance functions, resulting in lower costs, reduced financial risk and lower required reserves.

4. Improved internal and regulatory reporting capabilities

Within the scope of fulfilling risk regulatory reporting requirements the industry is currently heavily engaged in collecting data and developing/implementing processes and systems for compliance such as quantitative reporting templates (QRT), Solvency and Financial Condition Report (SFCR) and Regular Supervisory Report (RSR). In addition to these Solvency II specific requirements, industry will be challenged shortly to reflect accounting specifics International Financial Reporting Standards (IFRS) as well. By improving internal reporting and operational reporting to support risk-enhanced core insurance processes it will be crucial to provide consistency towards regulatory reporting and to make use of investments made in data governance and overall data management. However, as regulatory reporting and operational reporting on risk-enhanced insurance processes (e.g., product development, pricing) might often have different requirements concerning the actuality and granularity of underlying data, industry and IT experts will be asked to align these implementations in a cost efficient and synergetic manner.

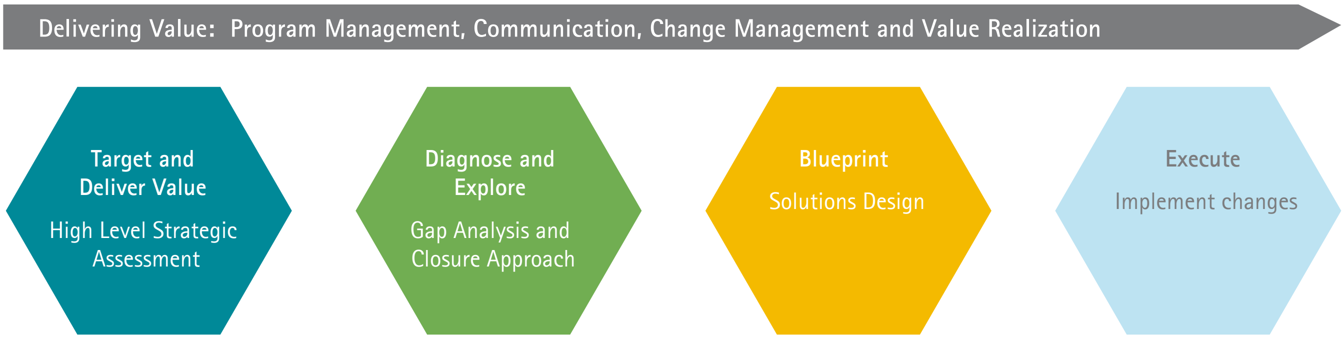
III. The Accenture Approach: The Risk-Adjusted Operating Model

We believe that the multiple challenges inherent in integrating and improving risk management are best addressed through a structured yet flexible approach. This allows for adaptation to the individual situation of each company and recognizes the maturity level of each company's risk management capabilities.

Accenture's approach – which we have termed the Risk-Adjusted Operating Model – seeks to align organization, processes and architecture to ensure the development of robust risk management capabilities and to generate benefits for the business as a whole. This is a step-by-step effort based on client specifics. (Figure 2)

Figure 2. The Accenture Risk-Adjusted Operating Model Approach

Accenture's Risk-Adjusted Operating Model Approach can help clients develop robust risk management capabilities that are aligned with their target level of sophistication



Source: Accenture

Targeting and Delivering Value

The Risk-Adjusted Operating Model typically begins with a high-level strategic assessment, designed to gain an understanding of the client's situation. The key objective is to identify attractive opportunities for adding value, which are then tracked and measured over the life of the project. The assessment also seeks to leverage the company's own expertise and experience to evaluate existing operations, risk capabilities, processes and systems. (Figure 3)

Working in tandem, the client and Accenture identify adjustment initiatives for the existing operating model and a timeline for implementation. The business case is calculated, based on client specifics including the complexity of the business, the maturity of existing risk management capabilities, and the client's key financial metrics, to estimate potential costs and benefits. Other key considerations include a review of industry benchmarks and the likelihood of quick "wins" in addition to medium- or long-term initiatives with corresponding benefits. Activities within this phase are supported by Accenture's ready-to-use assets for quick and cost-effective assessment.

Figure 3. Strategic assessment to identify opportunities for adding value

Gaining an understanding of the client's situation and challenges helps identify high level opportunities for creating value, which are then tracked and measured over the life of the project

- High level diagnostic of current risk management capabilities (Maturity Assessment)
- Operating model adjustments identified and socialized
- Indicative industry benefit benchmarks
- Strategic assessment to define business case for diagnostic and to identify compliance opportunities
- Metrics definition to track results

Source: Accenture

Diagnosis, Exploration and Blueprint Development

The next step in the development of the Risk-Adjusted Operating Model is an in-depth assessment of the client's market, business model and operating model to identify areas for improvement and opportunities for value capture. Together the client and Accenture benchmark and assess the existing risk management function, processes, technology and data capabilities against industry best practices, and also assess current capabilities against regulatory requirements. We identify areas for improvement in processes, policies, data, measurement and organization, formulating options for possible solutions and outlining both costs and benefits with the help of transparent business cases which are linked to the identified areas of adjustment. (Figure 4)

Figure 4. In-depth assessment to identify areas of improvement for value capture

Performing an in-depth assessment of a client's market, business and operating models help identify improvement areas and options for additional value capture

Diagnose and Explore

Gap Analysis and Closure Approach

- Benchmark risk management function
- Assess existing risk management processes, technology and data capabilities against the industry best practices
- Adjustments to operating model defined and considering:
  - -Strategy
  - -Organizational design
  - -Process and technology architectures
  - -Sourcing strategy

Source: Accenture

Blueprint

Once options have been selected, they are translated into concrete, detailed and actionable recommendations, including adjustments to the existing operating model and processes, to allow execution teams to implement them and capture identified value. Some changes in the operating model and its specific processes might be supported by adjustments in IT capabilities to ensure cost efficiency. (Figure 5)

Figure 5. Translating options into actionable recommendations

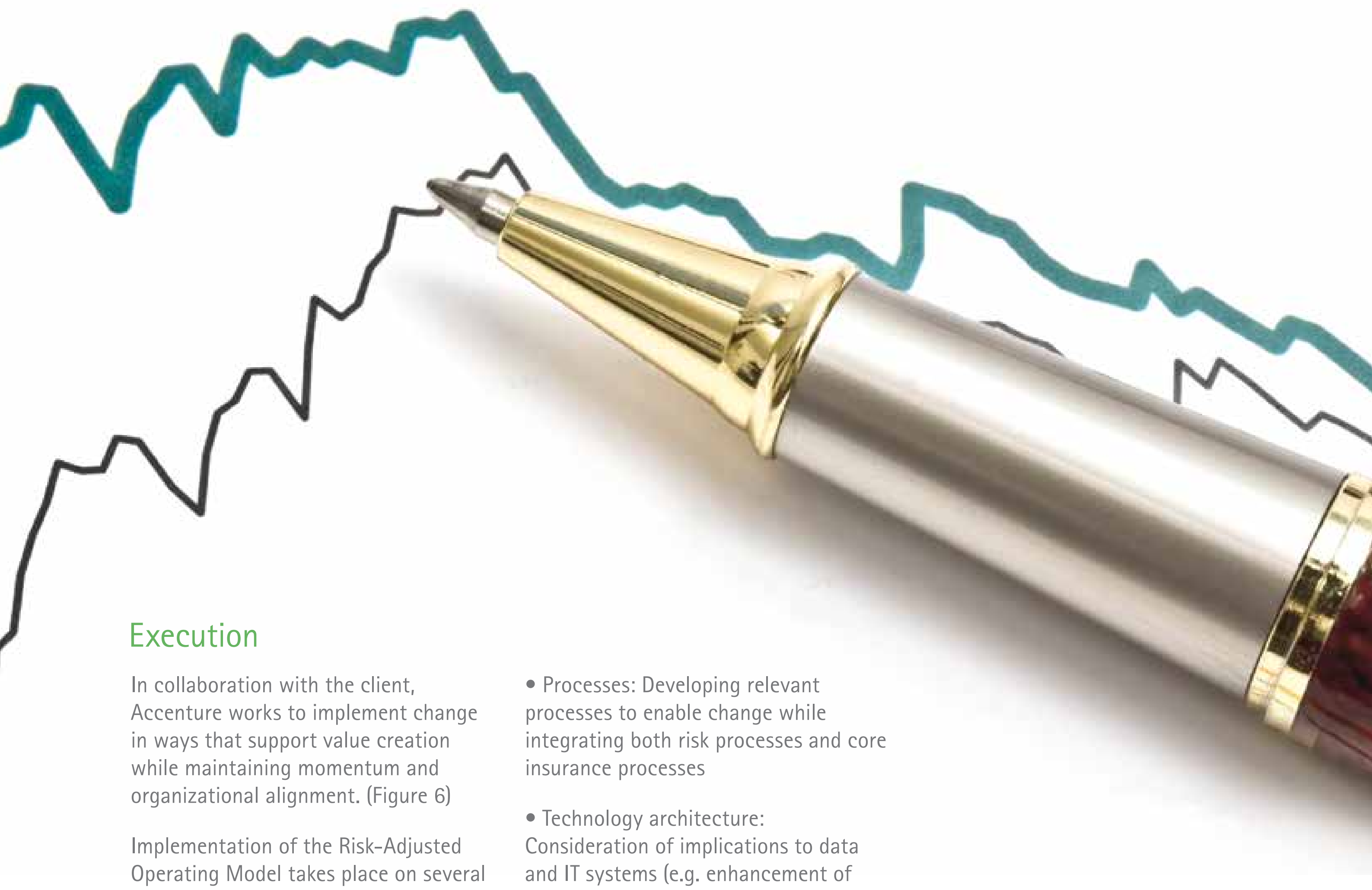
Translating high level options into concrete, detailed, and actionable recommendations at the capability level enable execution teams to implement and capture value

Blueprint

Solutions Design

- Design required organization adjustments (functions and processes)
- Software requirements identified and software selection conducted
- Implementation roadmap defined
- Business case for change developed

Source: Accenture



Execution

In collaboration with the client, Accenture works to implement change in ways that support value creation while maintaining momentum and organizational alignment. (Figure 6)

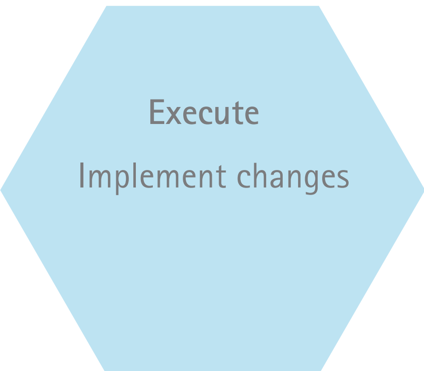
Implementation of the Risk-Adjusted Operating Model takes place on several levels, including:

- Organization and governance: Designing a logical, customized operating model and rolling out the new risk policy and strategy
- Processes: Developing relevant processes to enable change while integrating both risk processes and core insurance processes
- Technology architecture: Consideration of implications to data and IT systems (e.g. enhancement of existing core-insurance software, data flows and reporting capabilities)

As part of the execution of the change program, Accenture and the client team establish training initiatives, gather feedback from participants and make necessary adjustments.

Figure 6. Implementing the model across levels

Working collaboratively with the client to implement the model change helps maintains value creation, momentum, and organizational alignment, while transferring skills and knowledge along the way



- Adjusted operating model implemented on following levels: Organization and Governance, Processes and Technology Architecture
- Efficient and effective risk function supporting the business units
- Strong risk culture across the organization

Source: Accenture

Benefits from Risk-Adjusted Operating Model

Design and implementation of the Risk Adjusted Operating Model can yield significant benefits to insurers:

• **Value Generation** through wide contribution and usage of risk management capabilities to support decision making and value generating processes;

• **Improved business decision-making** through alignment of overall risk appetite and business strategy, helping increase the efficiency of capital utilization;

• **Improved business results** through integration of risk and core insurance processes and alignment of processes and systems – with alignment helping to reduce duplication of effort and non-value added activities – and data integration providing the platform for embedding risk within the business;

• **Enhanced operational efficiency** through an integrated and robust IT landscape, with a comprehensive and common IT landscape for multiple functions reducing risk management costs and increasing operational efficiency through improved automation and a consistent data management and quality framework.

Conclusion

Risk considerations should be integrated into all decisions regarding operations, capital management and management processes. Accenture's Risk-Adjusted Operating Model helps companies manage their enterprise-wide risks and aligns the risk management program with business and regulatory concerns.

By facilitating the achievement of strategic and operational objectives, this new model provides multiple approaches to measure and manage risks.

This approach is based upon Accenture's extensive experience in delivering comprehensive, end-to-end risk management projects.

Within these projects, Accenture has helped clients from strategic concept through project management through development and integration of IT applications. Accenture has the assets and practices to help clients obtain desired outcomes through the Risk-Adjusted Operating Model.

About the Authors

Eva Dewor

Eva Dewor is an executive director, responsible for Risk Management in Germany, Europe, Africa and Latin America, Insurance area. Based in Munich and with over 16 years of consulting experience, Eva Dewor specializes in helping organizations enhance their risk management capabilities through its integration in decision making, steering and reporting. Working with risk executives of multinationals from across the financial services industries, Eva helps them become high-performance businesses.

Markus Salchegger

Markus Salchegger is a senior director, responsible for Risk Management Insurance in Austria, Germany and Switzerland. Markus Salchegger holds a PhD in Mathematics, and over the past 15 years, he has used his extensive experience in insurance, reinsurance, banking, asset management and software development to analyze, design and deploy solutions for risk management and financial service applications that help clients become high-performance businesses.

Daniel Kimmerle

Daniel is a manager -Risk Management, based in Munich. Daniel uses his extensive experience in risk management and compliance to support insurers and reinsurers in analyzing, designing and implementing their risk management solutions and helping them comply with regulatory requirements and become high-performance businesses.

About Accenture Management Consulting

Accenture is a leading provider of management consulting services worldwide. Drawing on the extensive experience of its 16,000 management consultants globally, Accenture Management Consulting works with companies and governments to achieve high performance by combining broad and deep industry knowledge with functional capabilities to provide services in Strategy, Analytics, Customer Relationship Management, Finance and Enterprise Performance, Operations, Risk Management, Sustainability, and Talent and Organization.

About Accenture Risk Management

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.

About Accenture

Accenture is a global management consulting, technology services and outsourcing company, with more than 246,000 people serving clients in more than 120 countries. Combining unparalleled experience, comprehensive capabilities across all industries and business functions, and extensive research on the world's most successful companies, Accenture collaborates with clients to help them become high-performance businesses and governments. The company generated net revenues of US$25.5 billion for the fiscal year ended Aug. 31, 2011. Its home page is www.accenture.com.

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