



Case Study: How ERM Helped Turn Around Failing Programs

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LEARNING OBJECTIVES – WHY?

1. Learn the common ERM themes underlying several turn arounds
2. Understand how to apply ERM tools and practices to enhance returns
3. Articulate the value of an ERM program to the organization

DEFINITIONS

The term “Program” refers to:

- An individual company,
- A group of companies,
- A line of business,
- A territory, production segment
- A business unit or segment, entity, unit, or anything else that seems to make sense.

DISCLAIMER

- This is not the story of a single company, but rather a compendium of companies, business units, lines of business and so forth that I have worked with, and have learned about from others
- So far as I know, no single entity is as so bad as to exhibit all of the problems I will be describing

DISCLAIMER

- The materials contained in this presentation about any specific company cited can be obtained from publically available sources
- One reason that this is not the story of one company is that many of the problems I found were present in several programs
- The other reason is to protect the guilty (companies) and myself.

STEPS IN RISK MANAGEMENT

Use a Risk Management or ERM format to determine steps:

- Identify the risk
- Analyze the risk: Likelihood (frequency) and severity i.e. expected value
- Propose solutions: cost and speed to fix
- Prioritize
- Fix
- Monitor

AREAS TO CONSIDER

- Pricing
- Underwriting, Risk Selection
- Coverage, Rules and Forms
- Claims handling, Legal Environment
- Commissions, Other Expenses
- Investments
- And more

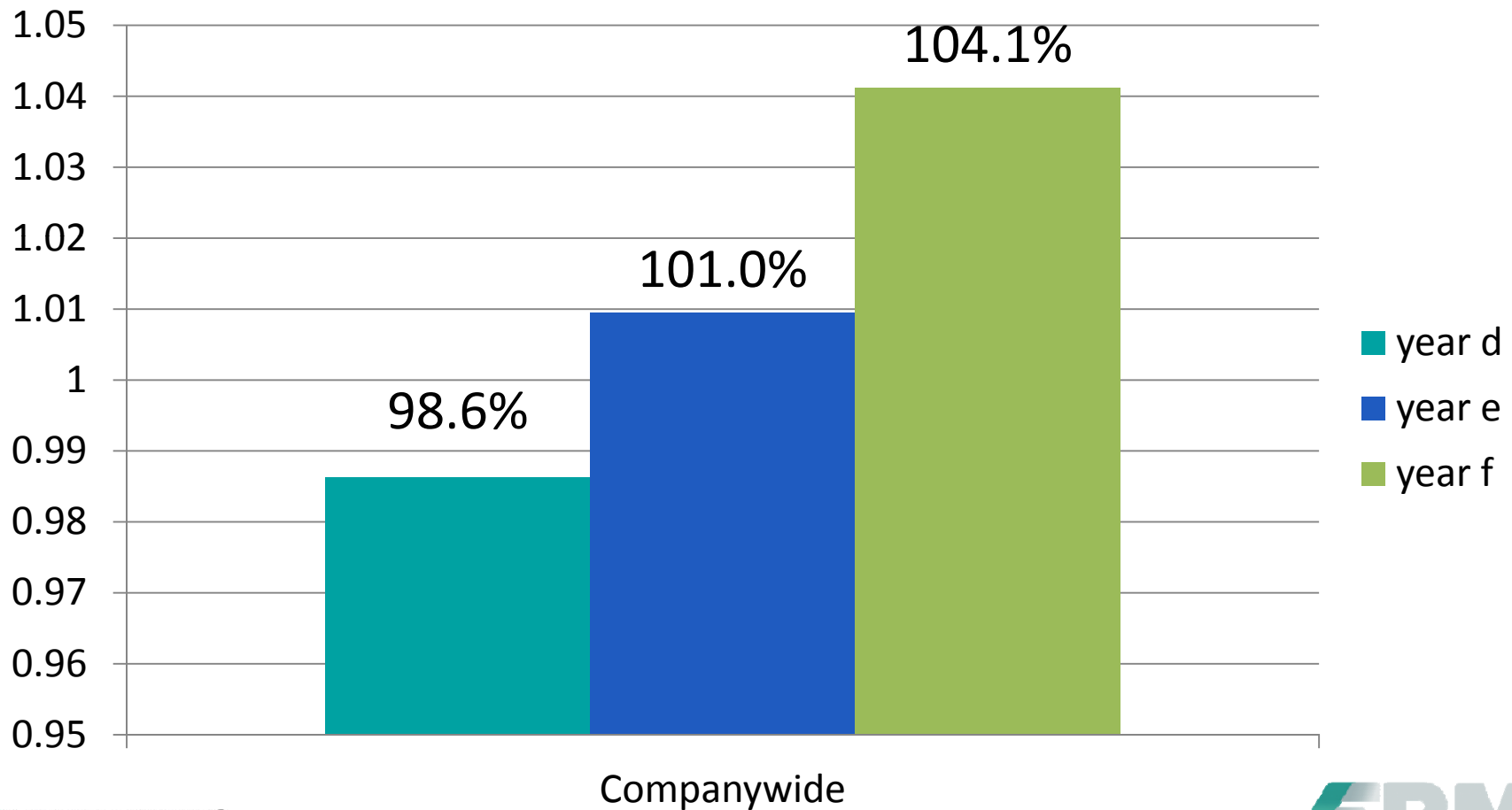
ARE THE PROBLEMS UNIQUE?

- Many of the problems I found were present in multiple programs
- Some were unique because of the uniqueness of the program or its operations
- Watch out for the process that you NEVER thought anyone would screw up
- Data and reports are often an issue

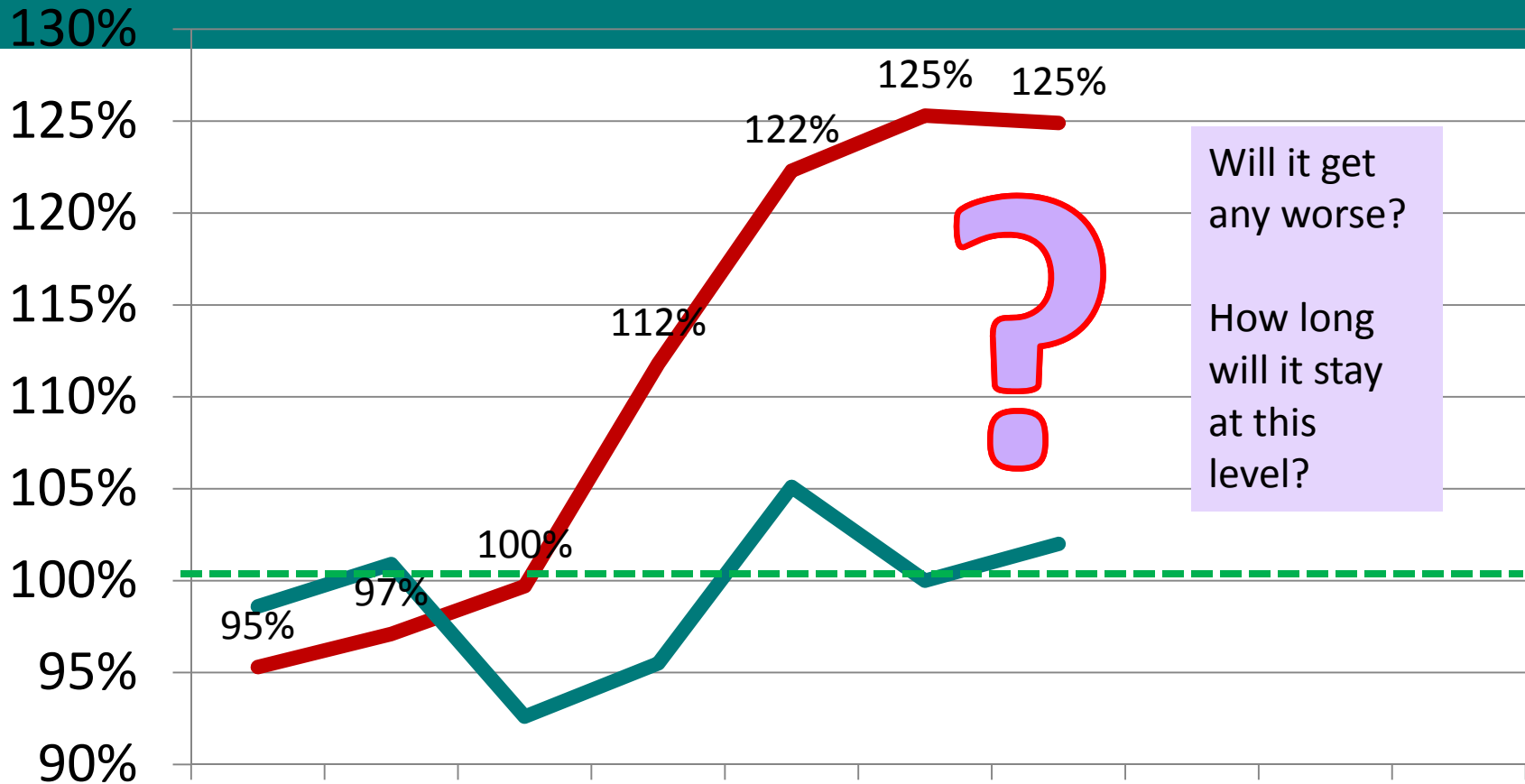
SO WHAT TO DO?

- Hire some consultants
- Hire someone specifically to make the turnaround happen
- Read some books, attend some seminars,
- Call people who have done it before – ask for advice
- Transfer to another department, business unit, or job to save yourself (abandon ship)

COMBINED RATIOS CASE A



COMBINED RATIOS CASE B



COMPANY CONDITIONS

Read the letters from the bottom up

Expanding Profitably

Growing Profitably

Accomplishing Purpose, Profitable

Maintaining, Break-Even

Surviving

Not surviving, insolvent, under supervision

SAGE*

SAGE stands For:

- **E**xpand
- **G**row
- **A**ccomplish (profit)
- **S**urvive

THE TEST: “SAGE” ©

Look at actions falling into one of the following categories:

- **“S”** Survive, that is keep the company alive
- **“A”** Accomplish corporate purposes
 - Maintain capital (Policyholder Surplus)
 - Move towards generating a Profit
- **“G”** Grow (organically)
- **“E”** Expand (grow beyond current operations)

Priorities need to be set to accomplish Survive (#1) and Accomplish (#2)

Growth and Expansion should be given lesser importance, if any attention at all.

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MORE ON SAGE

November 2010 *Actuarial Review*

“SAGE Advice” IMO column

www.RentAnActuary.com

“SAGE” page

CHECKPOINT

- Where, in the “SAGE” spectrum, is the program?
- If multiple programs, where is each of them

S A G E

CHECKPOINT: PROGRAM IS A COMPANY

- Check the policyholder surplus verses authorized control level indicated that the company wasn't about to be taken over by the state
 - (Annual Statement, page 17, lines 28 and 29)
- Are the remaining IRIS tests within acceptable ranges?

Determine: Can the state only watch, or are they about to seize control?

IRIS TESTS

- What is Net Premiums Written to PHS?
- What is BCAR?
- Adjusted liabilities to liquid assets - in range?
- Agents Balances okay? Trending?
- Are One- and Two-year reserve Development within acceptable range?
- Estimated Reserve Deficit to PHS within range
- How many of the 11 IRIS Ratios are outside the acceptable range?

WHAT YOU (LIKELY) DO NOT HAVE:

- Resources
 - Money
 - People
 - Expertise
 - Data
 - Reports
- Patience
 - The Board, Management, your boss, etc.
- Time

WHAT YOU MIGHT HAVE:

- A singleness of purpose
 - People pulling together to solve the problems
 - Absence of internal politics
- The ear of the Board, Management, your boss, etc.
 - Willingness to spend or do what is needed
- A sense of urgency

WHAT IS NEEDED

- Data – objective, correct, timely, relevant, etc.
- Objective analysis
- Options – not just one course of action
- Recommended action(s)
- Decisions
- Execution and follow through
- Monitoring of results

DATA, ANALYSIS AND DECISIONS

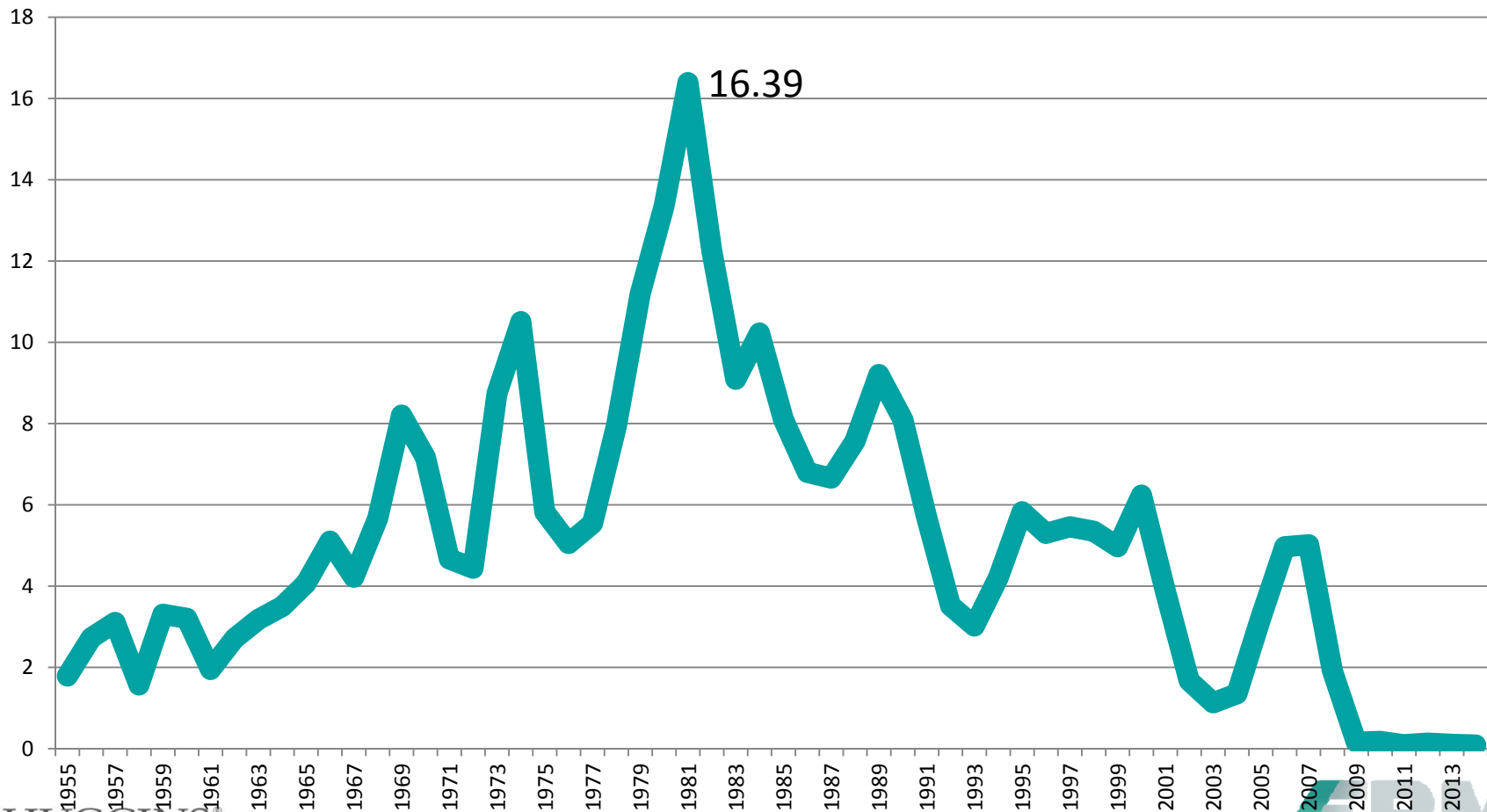
Start → Finish

- Decide on a course of action
- Present alternatives to decision makers
- Determine viable options
- Analyze the data
- Compile, assemble, sort the data
- Collect the data
- Define the data to be collected
- What problem do you want solved, question answered

CONSIDER

- Global economic environment
- Country's economic environment
- Your area, state or whatever's economic environment
- The competitive environment
 - Both outside your company and
 - Within your company

ANNUAL FEDERAL FUNDS RATE



ADDITIONAL POTENTIAL ISSUES

- Is there a Defined Benefits Pension plan and/or a liability for post retirement medical plans?
 - Are they causing significant gyrations in the PHS?
- Are there employee or bad faith claims that represent a potential significant losses that are not booked?
- What is the momentum of the results?

OPERATIONS AS A BUSINESS

- Don't forget that the company operates as other businesses do, with issues of coverage for it's own:
 - Workers' Comp
 - Auto liability
 - General Liability,
 - And other similar insurance-like risks.

PROGRAM CHECKPOINT

If the business unit within the company

- Look at the company's internal benchmarks, especially minimum returns or other minimum standards
- Look at alternate uses of capital, personnel, etc.
- Try to see if the program is out of favor, or a “favored” program

CHECKPOINT

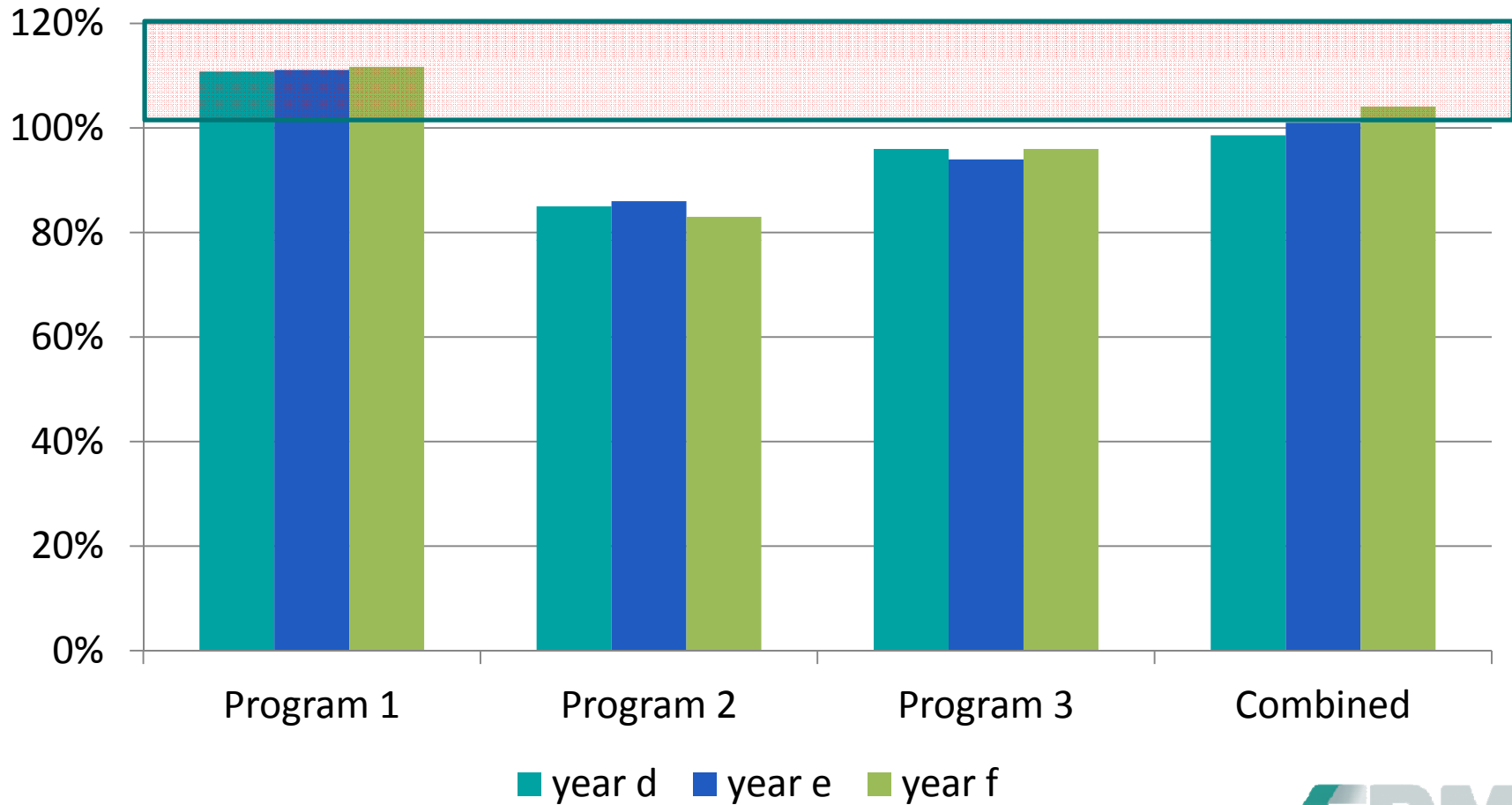
Determine if the business unit is even fixable.

- Will it succumb to its past before changes can be implemented?
- Does management have the resolve to fix the problems?
- Does management even know what the problems are?
 - If so, what have they done to try to fix the problems in the past?
 - If not, are they willing to listen to how to find the problems and what the solutions might be?

What to do?

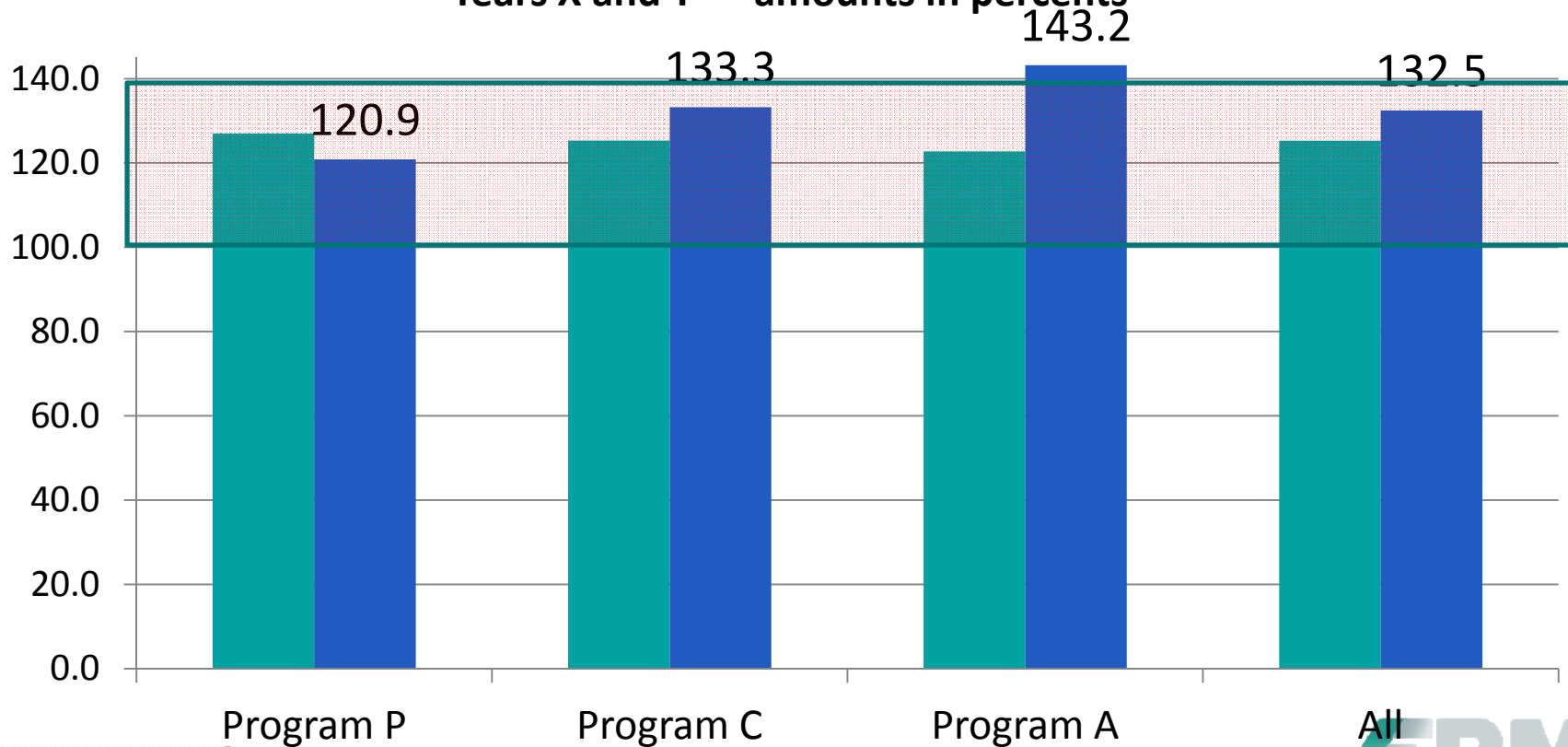
Where to start?

WHERE IS THE PROBLEM?



HOW DID IT LOOK BY PROGRAM?

Combined Ratios by Program For illustrative purposes only
Years X and Y amounts in percents



INTERNAL ALLOCATIONS

- Overhead in general (just spending too much everywhere)
- Reinsurance and its cost allocations
- Capital charges
- Investment allocations, if you are looking at total return metrics
- Information Technology and other Vendor costs
- Legacy costs, “pets”

IS REINSURANCE A PROBLEM?

- How much is Company Paying for Reinsurance?
- Is Reinsurance effective?
 - To Stabilize swings in results?
 - As Surplus Relief?
 - Are there Reinstatement charges?
 - Is it a multiple-year contract?

CHECKPOINT

Will you have the resources you need to carry out your portion of the changes needed?

- Time and personnel resources
- How much training will you need to do with the effected staff?
- Authority to direct those resources
- Data needs, and ability to obtain data not currently being compiled?
- Tools – software, hardware, etc.

You must get these BEFORE you accept the assignment!

CHECKPOINT

All of the leadership of the company or business unit **must agree on the vision** of fixing the company or business unit

If it is a business unit, the parent entity must agree with the business unit leaders on the vision of fixing the business unit.

HOW LONG WILL IT TAKE?

How fast you can accomplish the turnaround will depend on a lot of things, among them:

- Term of the policies, six month, annual, or up to six years (Vehicle Service Contracts)
- Regulatory climate concerning rates, rules and forms (Prior approval, File & Use, etc.)
- Regulations concerning underwriting e.g. Michigan's essential insurance act.

POTENTIAL SOLUTIONS

What any company can do about the problem program:

- Withdraw from the problematic program
- Correct the program's performance, if not too large and there is sufficient time and resources,
- Correct sub-sections of the program that are losing money
- Wait for the Underwriting Cycle to turn

SOME THINGS YOU NEED

- Data – and in a useable format
- Proper analysis of that data
- Recommend actions, based on data, that can quickly be deployed
- Work within the systems constraints
- You and the company needed to separate the facts from myth
- You might need to go outside to get some help with certain activities

ABOUT DECISION MAKING

Early on, you don't have much time to analyze and act.

As an actuary, you need to be willing to move away from perfection in your analysis, and willing to “be close enough.”

- if that bothers you, read the chapters on “the expected value of imperfect information” in “Decision Analysis” by Raffia – it used to be on the syllabus.

ANALYSIS

- Underwriting Reports – by all sorts of cuts, including by underwriter
- Territory volumes and loss ratio reports
- Cut the data any way you can think of
 - You are looking for pockets of profitability, and
 - Black holes of unprofitability

RECOMMENDED ITEMS

You likely will need to hasten the cycle of

- Data
- To Analysis
- To Recommendation
- To Decision
- To Deployment

**Your work does not count until it is ~~perfect~~.
deployed!**

CUTTING COSTS

- There are likely many costs that can be cut
 - It takes a lot of little savings to make up a big one
 - The story of two homes that we had built
- Problem, you have bigger things to do
 - Solution, assign a junior staffer to go after the medium and little costs that are unnecessary

AREAS IN WHICH TO LOOK

- Pre-sales
- At Point of sale
- Underwriting
- Pricing
- Claims

PRE-SALES ITEMS

- Advertising
- Web Presence
- Agency Plant

ATT TIME OF SALE

- Application completion
- Order of examination/selection process
- Validity of information

PRICING

CLAIMS

PROBLEMS WITH LINE B

- Company was “market of last resort” for many of its producers
- Company “took all comers”
- Underwriters were told to process the business and not verify risk information
- Antiquated policy issuance program
- Rates were based on competitors, who had succumbed to a “rate freeze” by the Governor

LINE B LINES MISSTEPS

- Starting rates were too low, and subsequent rate changes were “capped” to keep from “shocking the market”
- Company using only its own data for ratemaking, which was not credible for territories and other coverage variations
 - Later corrected by using industry data sources
- Launched revised policy issuance platform that was incomplete
 - Additional functionality was to be added later, but this has stalled due to other priorities.

WHAT WORKED WITH LINE B

- Underwriting now verifying risk information using a variety of sources, including outside vendors
 - Using such information to stop being “market of last resort:
- No longer providing rates through competitive raters for unprofitable segments of business
- Rate changes are aggressive and without capping
- Using industry data to supplement MMMIC data, due to credibility issues
 - Examples: HLDI, ISO, census track and others

PROBLEMS WITH LINE C

- “Deviated Experience Rating Plan” which was a marketing gimmick to give away premium
- Experience rated property exposures.
- “Split Rated” BOP based on old rates with tempering to limit changes to existing insureds
- Fleets were any group of two or more vehicles which were experience rated
- Underwriters were “undoing” rate increases filed by management with IRPM’s

LINE C MISSTEPS

- Reduced rates on certain “target” classes at a time competitors were getting out of many of them because of unprofitable results
 - Later corrected
 - Cost money and credibility with the producers
- Company failed to realize changes in economy would alter claims frequency

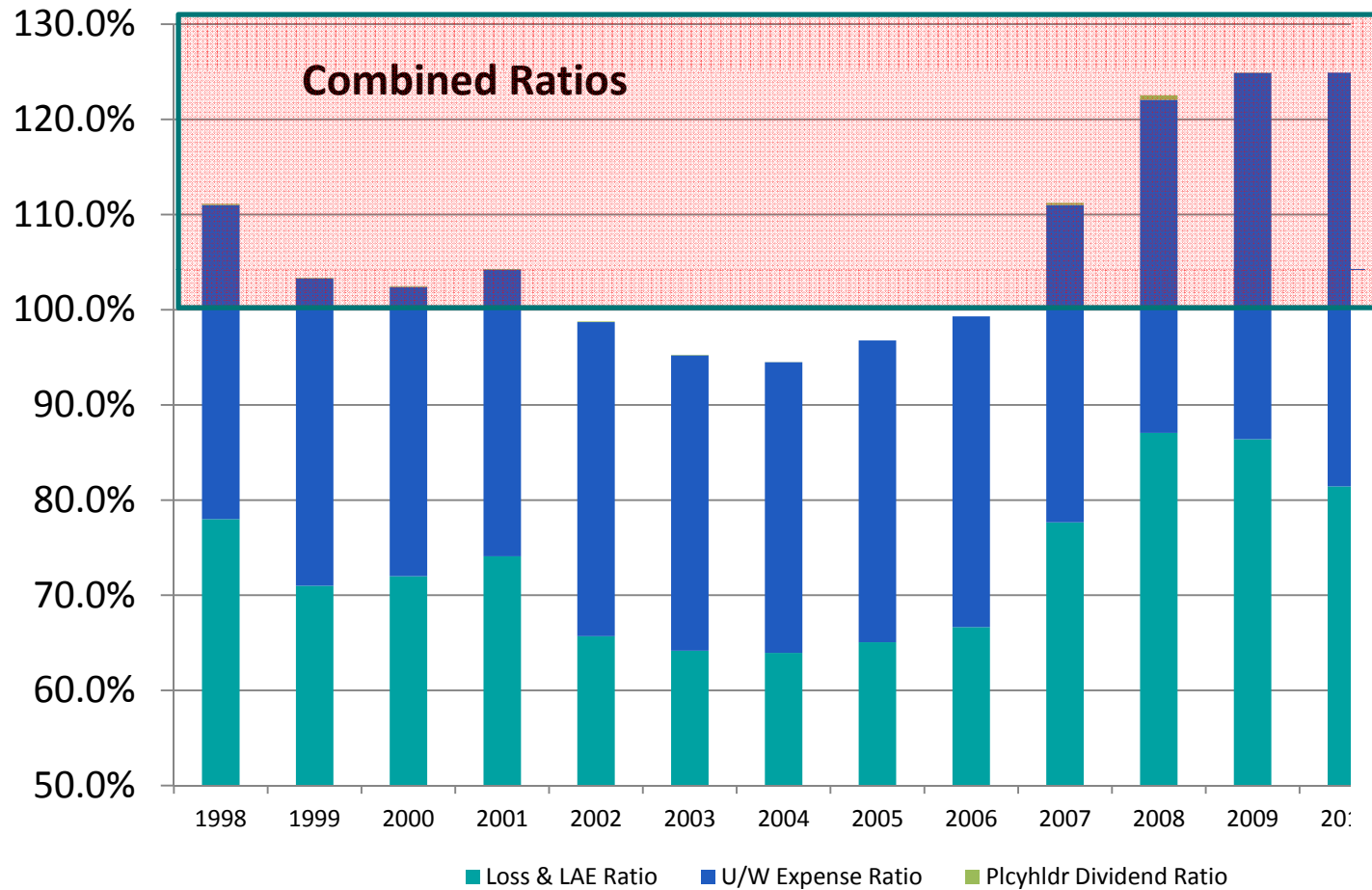
WHAT WORKED WITH LINE C

- Eliminated rating “gimmicks”
- Instituted common sense pricing programs and credits/charges
- Continual monitoring of rates – no longer reacting to financials but proactive
- Internal reports enable managers to view underwriters’ IRPM use as well as a variety of other risk metrics

PROBLEMS WITH LINE A

- A few very large agencies wrote a significant amount of the business and resisted any effort to make the book profitable for MMMIC
- Total Insured Value (TIV) was huge, especially considering the company's PHS
- Line A exposure drove up Reinsurance Costs

LINE A COMBINED RATIOS



SOLUTION TO LINE A

- Multiple attempts to increase rates to a profitable level did not produce the desired results
- Attempts to get the large agencies to cooperate were met with agreement in words but not in action
- While smaller business was profitable, it did not have sufficient volume to stand on its own
- Consequently, company was forced to withdraw from that market.

EXPENSE EFFECT OF WITHDRAWING FROM LINE A

- Loss of revenue drove up expense ratio portion of combined ratio
- Huge impact on cash flow
- Increased cost allocations to remaining lines of business (executive salaries, building, ledger system, phones, etc.)

CHECKPOINT

By the time you get things on the path to success, people will be used to working in panic mode and with gloomy prospects for the future

There will be a period, between the “fixing” and seeing the results on the income statement, that can be lethal – trust me!!

You have to prepare others for what they will be seeing, even before it manifests itself on the income statement.

Specifically, you need to prepare others for when you no longer need to take double digit rate increases!

POTENTIAL PROBLEMS WITH REINSURANCE

- Make sure reinsurance contracts are shared with the claims department, so there is no resulting failure to pursue reinsured claims
- Check reinsurance program for cost and efficiencies

CONSIDERATIONS TO FIX REINSURANCE

- Change your Reinsurance Broker
- President and VP's meet with new reinsurers regularly to review progress and plans
- Make sure Reinsurance Contracts are widely shared with claims, underwriting and anyone who needs them
- Consider having an outside "Reinsurance audit" to find reinsurance recoverables not previously identified nor submitted

ADDITIONAL ISSUES TO CONSIDER

- _____
- _____
- _____
- _____
- _____
- _____
- _____

CHECKPOINT

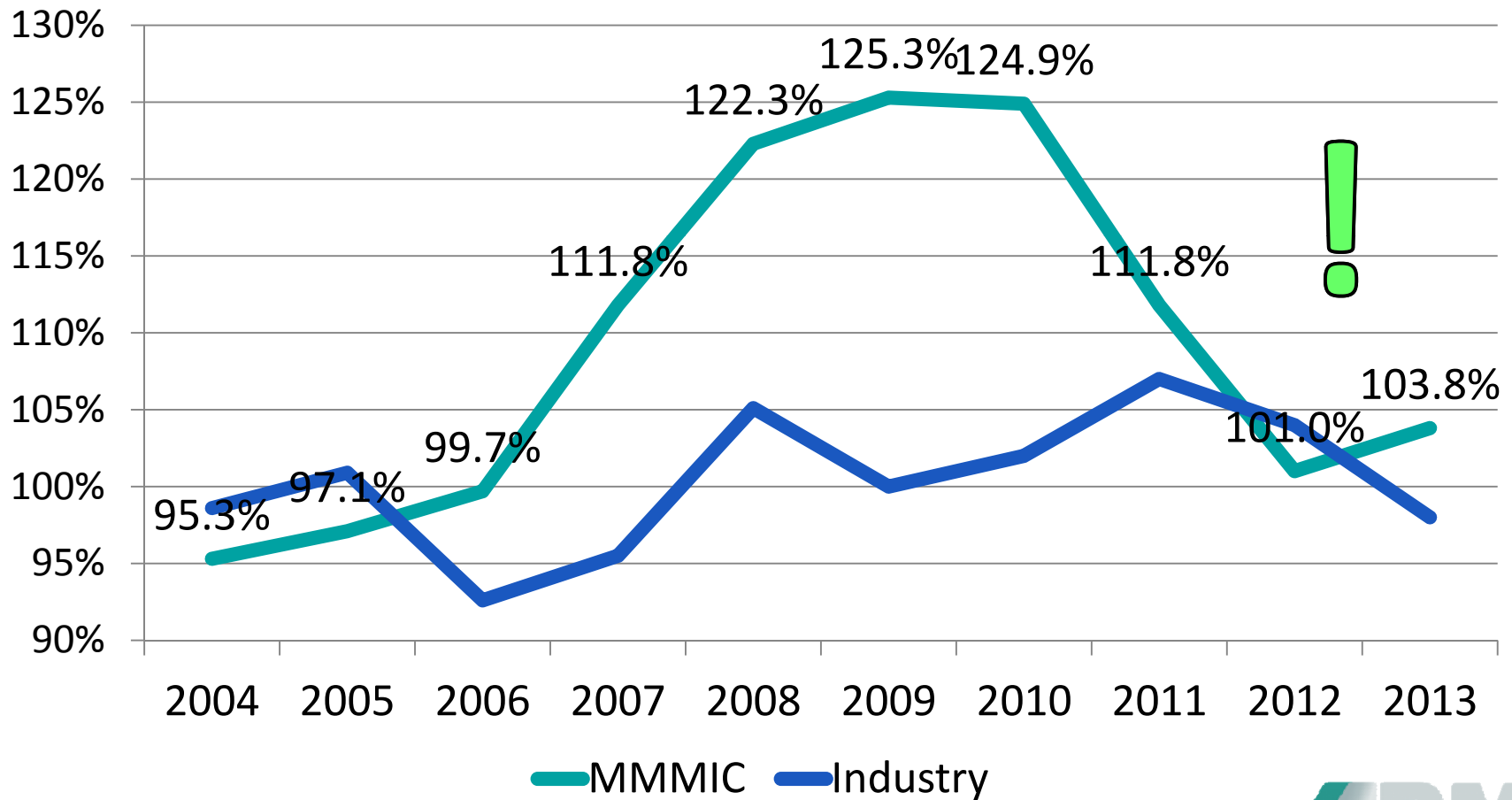
- Many small mutual's ONLY use Statutory Accounting, and only look at calendar year results.
- IBNR is only changed at the end of the year
- **THIS CAN CAUSE A SERIOUS PROBLEM WHEN LOOKING AT THE RESULTS DURING THE YEAR!**

BE AWARE OF YOUR AUDIENCES

- Board of Directors
- Agents/Producers
- Regulators
- AM Best
- Insureds
- Employees

“They Should Know” Actuarial Review,
Sept-Oct.2014 In My Opinion P. 36

COMBINED RATIOS CASE B



ONGOING

Periodically check every assumption

“It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so.”

- Mark Twain

Conclusion

Questions?
Comments?
Discussion!

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