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Using A “Connected” Enterprise to Manage Risk and Performance

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In today’s uncertain economic climate, enterprise risk management (ERM) and business performance management (BPM) have become the “hot” new management strategies that are top of mind for insurance and risk management executives.

ERM helps organizations comply with new regulations, such as the Sarbanes-Oxley Act, which require organizations to assess and manage risks more rigorously and systematically. By controlling risks, organizations achieve greater gains and competitive advantages in the market.

BPM allows organizations to automate and manage core business processes, such as claims management, in order to drive efficiency and productivity. While

organizations have always sought to improve business performance, the key difference with BPM is the use of an abundance of currently available analytical tools that can collect, report, and tightly manage performance statistics.

Sharing business performance and risk management objectives throughout the organization enables these goals to cascade down to individual employees and create a culture of success. Traditionally, organizations looked at BPM and ERM approaches separately, but managing risk and performance together can produce significant value, allowing organizations to drive performance while identifying potential threats along the way.

In order to accomplish this integration, an organization needs:

1. a thorough understanding of each approach;
2. an enterprisewide risk management infrastructure to capture and share claim, risk, and event information;

Historically, each division within an organization viewed and managed its own risks individually, in separate silos. Instead, ERM takes a holistic approach.

3. a data-reporting system that provides appropriate risk and performance information to various levels of the organization, including departments, business units, and the enterprise level;
4. a definition of “key performance measures” and “key risk indicators” to serve as benchmarks for organizational success; and
5. an ongoing monitoring system to compare goals against results and to keep appropriate staff and management informed of progress.

ERM: The Holistic Approach to Risk Management

Today, the process of anticipating risks and threats has become extremely difficult, especially since organizations must now take potential acts of terrorism, natural disasters, corporate governance issues, technology failures, and reputational risks into consideration, all of which are difficult to quantify and measure, let alone manage.

Historically, each division within an organization viewed and managed its own risks individually, in

separate silos. As a result, the organization had no way to quantify its exposure on an enterprise level. In many companies, management of the three prongs of risk — financial, operational, and strategic — was spread throughout the organization.

Instead of relying on this traditional siloed strategy, ERM takes a holistic approach. Priority risks are brought to the attention of senior management and the board of directors, so that those risks can be managed from the top down and a comprehensive plan can be developed to appropriately control, mitigate, and transfer all risks.

A Survey of Embedded Practices

Many executives seem to share the view that rigorous risk management is essential to corporate stability and long-term performance, but there has been very little information available to determine the degree to which ERM is actually integrated into current management practices and business processes.

As a result, in 2004, PricewaterhouseCoopers (PWC) released a global survey of 1,400 CEOs, which assessed how deeply formal ERM processes were embedded in their respective organizations. What the survey found was that ERM had essentially “come of age.”¹

At the time of the survey, ERM was a key priority among more than one-third of CEOs. Entry-level ERM, which involves six basic processes — risk identification, risk assessment, agreed patterns of response, risk controls, risk monitoring, and a regulatory compliance process — was reported to be embedded in 60 percent to 73 percent of the organizations,² and 13 percent to 33 percent of the companies had full ERM implementation,³ which included the following more sophisticated and deeply embedded set of capabilities and management practices.⁴

1. CEO has the information needed to manage risk at the enterprise level.
2. A common terminology or set of standards exists for managing risk.
3. ERM is fully integrated within the strategic planning process.
4. Risk management data are quantified to the greatest possible extent.

5. Risk management is fully integrated across all functions and business units.
6. All in the organization understand their level of personal accountability within the enterprise risk management framework.
7. The costs of regulatory compliance are closely tracked.
8. Compliance with regulatory requirements is closely managed and monitored to eliminate risk of noncompliance.

A Framework for Implementation

In order to help organizations implement ERM, in September 2004, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued the “Enterprise Risk Management — Integrated Framework” to provide an authoritative framework and road map — with common language, concepts, objectives, and components — for ERM implementation.⁵ In 1992, COSO had released the “Internal Control — Integrated Framework,” which became the U.S. standard for internal controls;⁶ its latest report aimed to become the equivalent standard for ERM.

COSO defines ERM as a process initiated by senior management or an organization’s board of directors that defines and quantifies risk in the context of an organization’s vision, mission, and business strategies; identifies potential events that may positively or negatively affect the organization’s objectives; and manages risks within a predefined risk appetite or tolerance.

The ERM framework will help organizations achieve organizational objectives in four areas: strategic, operational, reporting, and compliance. According to the framework, there are eight interrelated components that help to achieve these objectives.⁷

1. **Internal Environment.** The internal environment encompasses the tone of an organization and sets the basis for how risk is viewed and addressed by an entity’s people, including risk management philosophy and risk appetite, integrity and ethical values, and the environment in which the people operate.

2. **Objective Setting.** Objectives must exist before management can identify potential events affecting their achievement. Enterprise risk management ensures that management has a process in place to set objectives and that the chosen objectives support and align with the entity’s mission and are consistent with its risk appetite.
3. **Event Identification.** Internal and external events affecting achievement of an entity’s objectives must be identified and distinguished between risks and opportunities. Opportunities are channeled back to management’s strategy or objective-setting processes. Risks are assessed and acted upon as needed.
4. **Risk Assessment.** Risks are analyzed, considering likelihood and impact as a basis for determining how they should be managed. Risks are assessed on an inherent (exposure before any action is taken to manage it) and residual (remaining exposure after action has been taken) basis.
5. **Risk Response.** Management selects risk responses — avoiding, accepting, reducing, or sharing risk — and develops a set of actions to align risks with the entity’s risk tolerances and risk appetite.
6. **Control Activities.** Policies and procedures are established and implemented to help ensure that the risk responses are effectively carried out.
7. **Information and Communication.** Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.
8. **Monitoring.** The entirety of ERM is monitored and modifications are made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations, or both.

With this road map, organizations can begin to align their risk appetite with their business strategies; enhance their risk-response decisions; reduce operational surprises and losses; identify and manage multiple and cross-enterprise risks; seize opportunities; and improve deployment of capital.⁸

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Mandatory Compliance

Following the release of the PWC CEO Survey and the COSO ERM Integrated Framework, the past 12 to 18 months have seen a steady increase in ERM practices. In fact, so many companies have now implemented or begun to implement ERM that it is no longer considered futuristic.

Financial services firms were among the earliest adopters, and it is no surprise that this highly regulated sector has some of the best-developed ERM processes. Many organizations that were initially resistant to ERM programs due to the effort and expense are now moving forward with some basic ERM practices in order to comply with new regulations. For example, in 2002, the Sarbanes-Oxley Act introduced regulation of risk management for companies listed on U.S. stock exchanges. The Act obligates public companies to share information about corporate risks in order to make these risks transparent to shareholders and to utilize a rigorous ERM process to ensure that there's a reasonable chance of uncovering unknown threats.

In October 2005, the rating agency Standard & Poor's (S&P) introduced ERM strategy as a new factor in its analysis and rating of insurance companies. S&P assesses insurers' ERM strategy by evaluating five components: risk controls, extreme event management, risk and capital models, strategic risk management, and risk management culture.⁹ Organizations in all industries look to insurers to help them meet their own risk management challenges. As a result, the

new S&P rating requirement regarding ERM strategy will likely have a "trickle down" effect, with insurers encouraging and even requiring their business clients and vendors to implement ERM as well.

Barriers to Implementation

Although ERM is on the rise, many companies continue to flounder in their efforts to implement these programs. Although companies are identifying, assessing, and disclosing key risks, most have come up against serious obstacles in their efforts to embed ERM in their organization's decision-making process and culture.

As reported in the 2004 PWC survey, four factors stood out to CEOs as being significant barriers to ERM implementation: 1) the availability of information; 2) the timeliness of information; 3) the "people" issue, meaning the capability of personnel to effectively carry out an ERM framework; and 4) a fear that overregulation would create extensive demands on management, staff, and budgets, preventing organizations from implementing ERM.¹⁰

To be truly useful, ERM is dependent on the availability and timeliness of information reaching key decision-makers. Companies that have mastered the skills of ERM have also reduced the actual volume of data that gets reported to management, so these executives receive only key data elements, distinguished from the masses of unimportant or irrelevant information.

The challenge of training people to participate and be accountable in risk management initiatives is a significant issue, as is the need to foster an appropriate risk management culture. In many large organizations, there's been a long-running culture of ownership by the respective risk divisions, but today, as mandated by the Sarbanes-Oxley Act, an organizationwide culture of transparency is needed.

The burden of overregulation was perceived as another significant barrier. Ironically, although ERM will help to comply with certain regulations such as Sarbanes-Oxley, organizations must also deal with a host of other state, federal, and industry-specific regulations. For example, many states have new consumer privacy and workers compensation legislation. As the number of mandates grows, there's an increased likelihood that organizations may fail to comply with all of these new rules. Therefore, ERM strategies must become more sophisticated to encompass all

mandates. To make things even more complicated, the mandates have specific deadlines dates. Pressed to comply within a certain timeline, many organizations have been forced to pursue a piece-meal compliance approach. By spending money on these short-term solutions, however, organizations take funds away from a more comprehensive ERM framework that would wrap its arms around all mandates and provide a more long-term solution.

It is interesting to note that while a third of CEOs regarded the necessary investment in ERM to be a barrier to successful implementation, only 4 percent believed it to be a key barrier.¹¹ Although CEOs seemed to be interested in cost control, they also recognized that the overall benefits of ERM will outweigh initial investments in this area.

A Comprehensive Risk Management Information System

The PWC survey demonstrated that CEOs understand the centrality of information management to a successful ERM program. The availability of risk information continues to represent one of the key challenges to building and sustaining an ERM framework. In the next section, we'll take a look at the requirements of a risk management information system that will make the necessary decision-making information available.

Leveraging Existing BPM Infrastructure

First, it's important to realize that BPM can actually assist with an ERM strategy. The benefit of integrating ERM and BPM is that embedding risk management into routine business management activities will help to incorporate ERM into a company's culture. An organization's risk profile can have an impact on future performance, so reviewing performance outside of the context of risk essentially forces vital pieces of the business picture to go unnoticed and executives essentially to "fly blind" to impending threats.

In its most basic definition, BPM is a set of processes that helps organizations optimize business performance. A discipline that's been around a little longer than ERM, BPM has already helped to create a technology infrastructure that consolidates data from various sources, analyzes that data, and puts the results into practice. BPM offers real-time reviews and

feedback loops to identify and eliminate problems before they turn into significant issues and losses.

BPM utilizes key performance measures and reports to help companies monitor efficiency and performance against targeted business objectives. Its forecasting capabilities allow organizations to take corrective action if they are not on track to meet certain business objectives, such as expected earnings.

In order to achieve true ERM, key risk indicators must be defined, and the existing infrastructure must measure, analyze, and track these factors.

Finally, BPM is useful in risk analysis. Its processes and infrastructure help examine what-if scenarios, predict outcomes, and create a performance plan to deal with potential problem areas. As such, existing technology investments in BPM can be leveraged and extended to help facilitate an ERM practice.

However, in order to achieve true ERM, informational needs must extend beyond the metrics that fall under the BPM umbrella. Key risk indicators must also be defined, and the existing infrastructure must measure, analyze, and track these factors. In defining key risks, a good place to start is to look at what can go wrong with business processes and develop metrics that would signal an early warning of such scenarios.

The integration of BPM and ERM offers a significant value proposition to a growing number of companies, allowing them to understand the impact of risk on performance and to develop business processes to minimize and control risk into the future. The most difficult part of ERM is quantifying the financial impact of risks, which makes it difficult for organizations to build a business case justifying ERM implementation. It makes sense, however, that companies with well-managed risk tend to have fewer surprises and are better equipped to deal with problems when they arise. Proactive planning and preparedness can lead to overall gains and advantages in the market.

Sharing Risk and Performance Information via a Browser-Based Platform

Enterprise risk information must be communicated in a timely manner in order to be relevant to users. Sharing this information has traditionally been difficult because of disparate software platforms and separate information silos from various locations and business units. Today, modern distributed-component architecture, such as J2EE (Java 2 Platform, Enterprise Edition) and browser-based technology, integrates data across risk and performance silos. In addition, the Internet, service-oriented architecture, and data-exchange protocols have become ubiquitous, helping to facilitate a user-friendly consolidation of information from multiple platforms into a single software system, thereby providing an integrated view of the enterprise.

Utilizing a consolidated approach allows risk managers to comprehensively capture and monitor key metrics that will lead to improved risk and performance decisions.

In today's highly "connected" society, people are accustomed to the immediacy and real-time benefits of the Internet. As a result, many risk managers are comfortable leveraging browser-based solutions to take advantage of the connectivity, interoperability, and bottom-line benefits a browser-based platform provides.

Browser-Based Technology Provides Enterprise Connectivity

Virtually an unlimited number of users can connect, improving the gathering and sharing of information. Many organizations now operate in a distributed work environment with employees, claims professionals, and risk managers working at multiple, dispersed locations. As organizations leverage browser-based technology, a "centralized data hub" has evolved,

allowing various stakeholders to share risk and performance information in the pursuit of common business objectives.

Since browser-based solutions adhere to established protocols and standards, they are highly interoperable, meaning they easily integrate with other systems — such as finance, human resources, and underwriting — to further consolidate software systems into a "one-system" platform. Utilizing this consolidated approach allows risk managers to comprehensively capture and monitor key metrics that will lead to improved risk and performance decisions.

This browser-based platform allows organizations to foster ERM and BPM at every level of the organization and puts risk and performance indicators in the hands of the managers more quickly. Business units and frontline managers can remotely access the centralized data hub to manage their respective departments. At the same time, the executive team and board of directors can also assess key performance measures and key risk indicators using an enterprise perspective to drive business strategy.

Benefits of an Integrated One-System Solution

With real-time business intelligence, this integrated "one-system" solution helps organizations to react more nimbly to risks in a competitive environment. Risk managers who have already begun to leverage browser-based technology are now driving initiatives with great control, collaboration, and cost-savings. These browser-based platforms also provide the following benefits:

- **Transparency.** Information transparency is a key requirement under Sarbanes-Oxley, calling for real-time disclosure of material changes to an organization's financial standing. In the past, auditors relied on paper trails and paper-based transactions as part of the internal control and audit process. As the risk management process becomes more electronic, organizations will need systems that provide auditable and transparent controls. Browser-based technology provides the ability to track, monitor, and audit key transactions online.
- **Event Tracking.** One of the major components under the ERM framework is identifying internal

and external events that may affect the achievement of an organization's objectives. Today, the one-system approach afforded by browser-based technology allows organizations to incorporate events management and tracking into the common system platform. This integration provides a convenient way to capture event information after an incident has occurred and, when the event must turn into a claim, the information can be forwarded to an appropriate claims adjuster. Since all event information is captured electronically, reports can be generated to identify risk trends, provide benchmarking, and reveal potential business opportunities.

- **Risk Alerts.** With rules-based technology, an array of risk alerts can be programmed. If key risk indicators hit a certain level, the appropriate manager can be notified immediately via e-mail, pager, or mobile phone. Going forward, these risk alerts enable organizations to initiate a timely response and intervention that minimizes potential negative outcomes. These alerts can be customized as necessary. In the case of a detrimental "lack of action," an alert can trigger appropriate notification of time-sensitive compliance requirements.
- **Risk and Performance Reports.** From the centralized data hub, organizations can customize specific risk management reports that track their particular "key risk indicators" and "key performance measures." These reports allow organizations to identify problem areas and implement timely interventions that help reduce risks and improve performance. Leveraging Internet-based distribution, organizations can automatically generate and schedule reports to be distributed via e-mail, allowing executives, management, and the board to stay abreast of an organization's risk and performance.

The Starting Point: A Connected Claims Enterprise

Although we've been discussing organizations in general, this section will focus on the insurance industry and look at insurers, self-insured organizations that manage their own claims or utilize a third-party administrator, and risk management entities such as pools. How do these organizations begin to lever-

age their existing BPM infrastructure to also foster ERM practices? One place to start is with the claims system.

Claims management is a focal point in BPM for insurance organizations, and existing claims software contains valuable risk information for ERM efforts. As a result, insurance organizations are combining claims and risk management to initiate an integrated BPM-ERM approach that improves claims processing efficiency and ultimately reduces future risks and losses. Of course, ERM must also go beyond claims management in order to facilitate an enterprise view of risks, but it's a good starting point that leverages existing BPM infrastructure.

These organizations have long embraced technology as a way to streamline their claims operations and to improve performance in a number of areas, but they have also looked to their claims operation to support business objectives, growth, customer service, and profitability.

Improving Productivity and Quality

In the past, the claims adjuster functioned as the "traffic cop," routing claims to the right department or expert and ensuring that the right tasks were performed at the right time. However, with the shortage of claims professionals and with existing adjusters handling anywhere from 150 to 200 claims at any given time, a browser-based infrastructure has had to evolve in order to improve efficiency and to focus specialized experts where they're most needed.

The new paradigm of BPM in claims management leverages workflow management tools to create an automated "traffic control center." It utilizes technology and automation to ensure that tasks are handled in a timely manner and claims are routed to the right resource. Scanning and digital files have enabled organizations to use electronic claim files and have further facilitated an end-to-end automated and electronic process.

These workflow management tools provide transactional-costs savings and reduce traditional bottlenecks in the claims process. All this ultimately helps organizations to achieve resource optimization and a "high-octane" workflow, in which resources are not wasted and organizations actually get more done with fewer resources.

Consistency has long been a challenge in the claims process. Studies have shown that the same complex

claim given to two different adjusters can produce widely divergent results. The BPM discipline has applied rules-based technology to ensure a consistent application of best practices. The rules engine can be configured to route complex cases to adjusters with the most experience and to automatically ensure specific procedures are performed in a timely manner, such as completing the three points of contact (contacting the claimant, physician, and employer after a claim is filed) and the initial claims investigation.

With the centralized data hub, organizations have a 360-degree view of risk and performance.

To further ensure quality claims handling, claims managers perform concurrent, online audits of 100 percent of claims rather than the traditional retrospective 20-percent sampling. These audits ensure that adjusters are adhering to best practices and that claims are being reviewed in a consistent, quality manner. Audits also allow claims managers to continually fine-tune operations. The result is improved overall costs and outcomes in claims.

Business Intelligence at an Enterprise Level

In the past, there was no effective way to look at claims experience and risk components from an enterprise level. Now, with the centralized data hub, information is compiled in one location and shared across the entire claims and risk management value chain. Various risk and performance reports are automatically routed via the Internet to appropriate parties for analysis and monitoring. As a result, organizations have a 360-degree view of risk and performance.

This real-time availability of business intelligence allows risk managers to target high-cost, high-risk areas with risk control and prevention initiatives. Risk managers also analyze loss information to make more effective risk financing decisions. For instance, they can calculate how much risk they can retain and the savings they can expect. Executive management can also use this information to address high-cost areas with cost-saving initiatives that drive bottom-line improvements. All this leads to improved ERM and

BPM efforts. The browser-based infrastructure also allows organizations to have the flexibility to switch vendors and add system components, enabling adaptation to changing business needs far into the future.

For insurers, timely claims data are the lifeblood of accurate underwriting and policy decision-making. While insurers have always gathered a sizable amount of claims information, data were traditionally tied up in paper files or slowed down by disjointed systems. Without detailed loss information, policy pricing may have been set too low to cover a client's claims experience or loss trends. Today, sharing claims data via the centralized data hub allows an insurer to reduce its risks in underwriting and renewing clients while also improving the bottom line.

Fostering an ERM Culture

With so many parties involved in risk management, it is difficult to align stakeholders on common ERM goals. Today, organizations cannot ignore the role a centralized data hub can play in establishing a risk management culture. Fostering culture requires a systematic approach to building awareness of ERM practices and objectives. From the hub, organizations can provide people at all levels with the reasoning behind an ERM program and information so that they can participate and improve ERM results.

At the same time, the browser-based infrastructure of the hub provides organizations with powerful oversight capabilities that enhance management of ERM programs. Through this oversight function, risk managers can establish roles and responsibilities and cultivate accountability to these functions. Risk managers can also run ad hoc reports when necessary without relying on an IT department. These flexible reports can drill down to the kernels of data that help identify emerging risk factors.

Taking the Claims Infrastructure to the Next Level of ERM

The current generation of risk management information systems (RMISs) is designed to support claims processing. The basic risk management data record closely resembles a claim's data record. However, the claims infrastructure must be taken to the next level in order to enable full ERM implementation.

For ERM to be truly effective, a RMIS cannot simply collect claims data. It must be extended to track and manage events and incidents and to assess them according to potential risks and opportunities. The

design must also evolve to deal with uncertainty and unquantifiable risks and to contend with operational and strategic risks as well as traditional financial and loss-related risks. It must have the capability to analyze data, identify risk patterns, prioritize risks, recommend appropriate mitigation actions, and, in some cases, execute those activities.

The data analytics must not only consider historical information but also project what-if scenarios and the impact of events that have never yet occurred. ERM requires technology to project a possible chain of events that may follow an initial claim or loss event and to come up with a strategy to control this ripple effect in order to reduce negative outcomes. In order to perform these futuristic ERM functions, an ERM solution must incorporate predictive and causal models.

The Age of ERM

In many cases, ERM is a mandated practice, but organizations are developing a strategy of compliance that will, at the same time, anticipate risks in order to gain market advantage in a competitive environment.

The ERM discipline requires timely information, professional expertise, and technology tools in order to be successfully implemented. Instead of rebuilding the wheel, many organizations are initiating ERM programs by leveraging existing BPM infrastructure. For these organizations, BPM is typically housed in the claims department, where browser-based technology has helped to create a one-system approach and a centralized data hub. Using the BPM infrastructure as a starting point, organizations have begun to build a single view of the enterprise and to orchestrate the management of both risk and performance.

Where do we go from here? The integrated ERM-BPM infrastructure must be extended to enable more futuristic ERM capabilities, such as taking uncertainty into account and projecting the potential impact of events that have not yet occurred. The ERM future looks bright and, although it will require an extensive investment in time, effort, people, and technology, the end result will be a more balanced approach to risk and reward that is aligned with an organization's strategy and objectives.

Endnotes

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