March 2017

The Business Planning Process

Building Momentum Towards Better Business Decisions

Audit / Tax / Advisory / Risk / Performance

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Insurance companies appreciate the need to develop a better understanding of the risk exposures within their company and hold capital to mitigate these risks in an efficient manner. Striking a balance between the risks assumed and the rewards generated can be challenging, especially during the often frantic business planning exercise, which is the key mechanism by which the board decides how best to implement its strategy.

One way to proactively consider risk within the business planning process is to use the Crowe Corporate Calendar (Exhibit 1), which provides a view of those key activities which are facilitated by risk information.

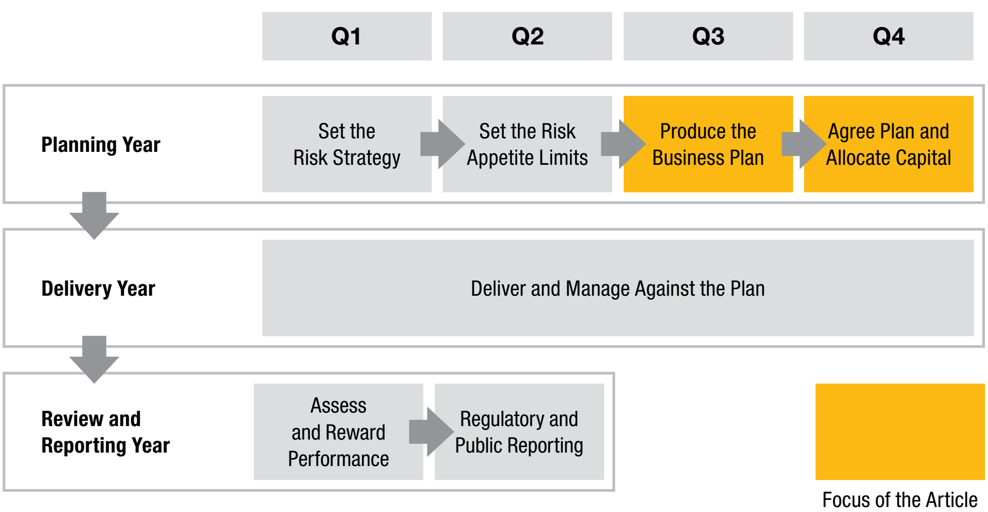
- The planning year: includes decisions and activities which are forward-looking and prepare the company for the year ahead
- The delivery year: involves executing the business plan agreed during the planning year
- The review and reporting year: assesses the previous year's business performance and reports results to the supervisor and the external market

Prior to the business planning process commencing, the board signs off the risk strategy in addition to any changes in the wider business strategy. Subsequently, a target risk profile is developed to ensure continuing alignment of risk preferences and the strategic objectives of the board over time.

Our article "Risk Strategy and Risk Appetite Limits – A Solid Foundation for Better Business Decisions"[1] explored how an insurance company, facilitated by the Crowe Corporate Calendar, may set a risk strategy and risk appetite limits. This article explores how this information supports the business planning process to ensure that risk is a key consideration when developing the business plan.

Accordingly, the second half of the planning year can then ensure that the risk strategy, business strategy and risk capital limits (consistent with the target risk profile) are reflected in business planning activities. Subject to wider commercial and regulatory considerations, capital can then be allocated to those opportunities that offer the best risk-adjusted return.

Exhibit 1: The Corporate Calendar



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A business plan that adequately reflects risk is a key tool to support decision-making across the typical corporate calendar (Exhibit 2). Producing the business plan, agreeing the plan and allocating capital can be split into three stages, each of which is explored in more detail in this article.

1. Preparation and Planning: Establishing a Solid Foundation for Better Business Decisions

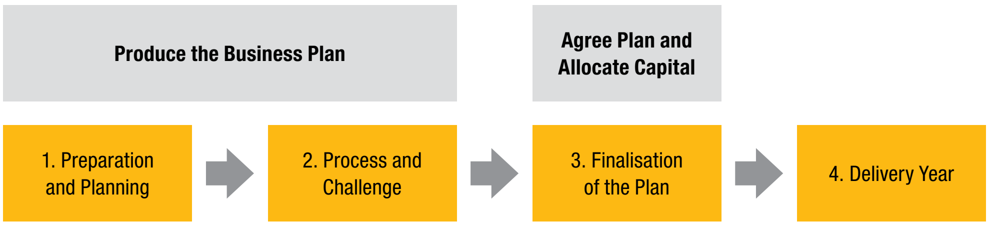
To enable the timely and robust production of a business plan, with comprehensive consideration of the trade-off between risk and rewards, the following sources of information should be considered:

- Strategic goals of the board: Provide the outline of key objectives that the business plan must meet, such as high-level business volumes, launching new products or moving into new territories.
- Prior year's business plan: Provides useful information as plans will likely remain relatively similar year on year unless there are significant changes to strategy or the structure of the business.
- Target risk profile: Set in reference to the new risk strategy and the wider business strategy, this will indicate the level of risk that the board is willing to accept to meet its key strategic objectives. The associated risk capital limits provide constraints for the amount of risk within which the business plan should adhere to drive towards the target risk profile.
- Other constraints: Any other limiting factors, such as meeting regulatory requirements or any broader commercial considerations.

Collectively, these items help provide the boundaries within which to develop the business plan and ensure appropriate consideration of the risks associated with that plan.

> The business plan is produced to reflect the risk preferences outlined in the risk strategy and to ensure movement towards the target risk profile over the business planning period, whilst also allowing for other issues such as wider commercial and regulatory constraints. This will help ensure that the business plan has given proactive consideration to risk exposures and capital requirements.

Exhibit 2: The Business Planning Process



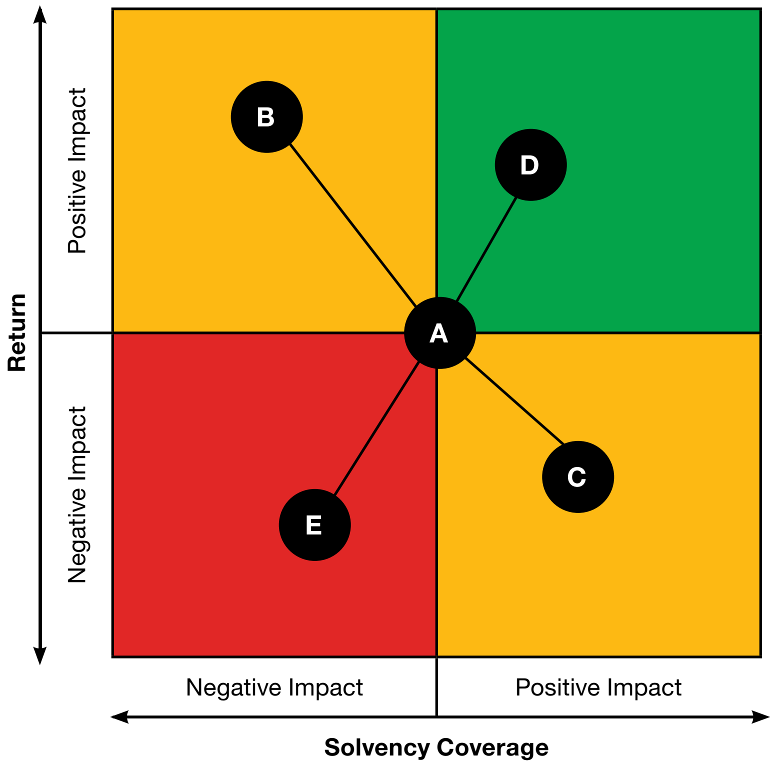
2. Process and Challenge: Building Momentum Towards Better Business Decisions

The business plan must use the supporting information outlined in the previous section to ensure sufficient consideration of the risk being taken and the rewards potentially generated.

A number of potential opportunities may be considered when developing the plan, as illustrated in Exhibit 3:

- Circle A relates to the current position, assuming last year's plan has delivered in line with expectations.
- If the business has spare capital to invest in projects and opportunities, it may choose opportunity B, as it will increase returns albeit with a reduced solvency coverage ratio. An example may be choosing to write higher volumes of new business.
- The business may want to reduce certain risk exposures through implementation of an appropriate hedging strategy. This will increase the solvency ratio whilst potentially reducing the potential returns, as highlighted by opportunity C.
- It may be possible to identify opportunities such as those highlighted by circle D, where both risk-adjusted profits and the solvency ratio increases. This may be achievable by, for example, ensuring a more balanced exposure to different risks and hence increasing diversification benefits and reducing capital requirements.
- Any opportunity such as that highlighted by E should be avoided, as both expected returns and solvency coverage reduce.

Exhibit 3: Risk Versus Return Trade-Off



Being mindful of the risk versus reward relationship, a business plan will need to include robust stress and scenario testing, to identify whether the strategic goals can still be met under adverse conditions.

The business plan may require a number of iterations before settling on the most appropriate balance of risk and reward. Accordingly, robust governance processes are required to ensure rigorous review and challenge.

If the company is a group, the central function will need to aggregate risk across the business units to assess whether risk and reward balance is achieved across the group.

3. Finalisation of the Plan

Once the final business plan is agreed by the board, capital can be formally allocated to different business units, projects and opportunities. Accordingly, capital will be allocated to these activities that provide an appropriate balance between risk and reward whilst also adhering to the board's risk strategy and business strategy.

4. The Delivery Year

In the delivery year, the company will be implementing the business plan that was produced in the planning year. Delivery against the plan is monitored and reviewed though practical and timely management information and robust and effective day-to-day risk management activities. This helps to identify and manage issues as they arise.

Ongoing risk management activities also include assessment of the solvency position and continuing adherence to risk appetite limits.

In Summary

The business planning process must ensure appropriate consideration of the potential risks, as well as the rewards. This is facilitated by stress and scenario testing and robust governance arrangements. Once the business plan is agreed by the board, capital can be allocated to business units, projects and opportunities. Consideration of a range of risk information during the business planning process will ensure that the capital allocated is aligned to the board's risk preferences and strategic objectives.

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[1] "Risk Strategy and Risk Appetite Limits – A Solid Foundation for Better Business Decisions," BaxterBruce, 2015, http://www.baxterbruce.com/articles/risk-strategy-risk-appetite-limits-a-solid-foundation-for-better-business-decisions/

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