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THE MANAGEMENT OF AN INSURANCE COMPANY

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Abstract

The management of an insurance company is based on a whole series of actions, whose finality can be found in obtaining and keeping a balance among the functions of the management, so as to ensure the success of the company on the market: the forecast function (substantiated in forecasts, plans and budgets), the organization function (completed with the achievement of the company objectives), the coordination functions (carried out between a manager and a subordinate or between a manager and several subordinates), the training function and the control function (which imply measuring the results, comparing the achievements, determining the causes that led to deviations, making corrections, etc.). This paper describes a few peculiarities, related to the decision-making process of an insurance company.

1. INTRODUCTION

One of the lessons taught by the crisis is that all the financial services must take place in an integrated market combining risk management and supervision. The separate regulation in the banking field, of the insurance and of the financial services paved the way for regulatory arbitrage, which is one of the roots of the current crisis. Due to the differences between the business models (the insurers are required to establish technical reserves, and they only pay compensations if the insured risk occurs, and they have a diversified portfolio, which is not correlated with the assets owned and therefore is not generally correlated to the capital market; in the banking sector, outstanding loans are correlated with economic factors of general interest), the insurance companies were less affected than the banking sector. The effects of the crisis on the insurance industry can be presented by listing certain representative cases: the rescue by the U.S. government of the company AIG, the depreciations recorded by the reinsurer Swiss-Re due to the re-insurance of the loan portfolios and the insolvency of the company Yamato Life Insurance caused by the failures of the management in managing assets. Only part of the insurers was affected by the investments in structured loan products, most of them being indirectly affected by investment losses caused by the collapse of the capital markets. Such negative effects in the asset management generated a sharp weakening of the financial situation of the company Yamato Life Insurance and eventually led to its insolvency, despite of the fact that there was no specific underwriting risk issue reported.

The financial management of the insurance company is different from the one of the companies in other fields, and has unique features, such as: the low proportion of frozen assets and financial claims, the minimal use of the leverage, insurance companies do not need long-term debts, because they can use the policyholders' funds. These funds, comprising premium reserves, compensation reserves for goods and liability insurers, and technical reserve for life insurers, can be invested.

2. FIGURES, TABLES AND EQUATIONS

Insurance companies are business entities organised as trading companies providing services and operating in a specific market to get the profit targeted by the shareholders. The insurance products have peculiarities and valences with a particular specificity and determine a special approach of the insurance company management.

The insurance economy has recently undergone significant changes in the evolution and action of the insurance companies in Romania. While 14-15 years ago the economic and financial decision was territorially decentralized down to city level, 4-5 years ago the decentralization was restrained to an upper level, namely the branch established at county administrative level. Currently centralism is manifested, as well as authority in absolute decision in the top of the decision-making pyramid. There are insurance companies that have established regional decision-making centres with a technical structure and there are other companies that have informational decision-making centres through an area coordinator. The changes in the strategy have two causes: the maximization of the profit and foreign shareholders' fear of fraud caused by the own employees.

The knowledge of the managerial peculiarities and the insurance management influence factors (the random nature of compensations; the legal form of the insurance; the insurance branch; the territorial insurance scope; the size of the funds established by the company; the outsourcing of the activity; the peculiarities of the insurance marketing activity) provides the management team with the opportunity to meet the managerial requirements and objectives, completed by building the insurance fund in due time and in the provided amount, the adjustment to the requirements of the insurance market and getting profit.

Insurance management must provide optimal conditions for: establishing the insurance fund in the provided amount (done by improving and streamlining the insurance contracting activity and the collection of the insurance premiums); quick granting of the compensations and insured amounts to which policyholders are entitled when the insured risks occur (achieved by providing the promptness and correctness of the operations of ascertainment, damage assessment and determination of the compensation); the continuous adjustment of the insurance forms (optional and by virtue of the law) of property, persons, and civil liability to the requirements emerging on the domestic and foreign insurance and reinsurance market; the maximization of the insurance coverage in order to achieve an optimum dispersion of the risks, etc.

The management of an insurance company is based on a whole series of actions, whose finality can be found in obtaining and keeping a balance among the functions of the management, so as to ensure the success of the company on the market: the forecast function (substantiated in forecasts, plans and budgets), the organization function (completed with the achievement of the company objectives), the coordination functions (carried out between a manager and a subordinate or between a manager and several subordinates), the training function and the control function (which imply measuring the results, comparing the achievements, determining the causes that led to deviations, making corrections, etc.). This paper describes a few peculiarities, related to the decision-making process of an insurance company.

In an insurance company, *the peculiarities of the planning activity* are determined by: the general strategy, the long-term and short-term objectives; the budget and the manner of allocating resources; the company policies on each field and the procedures of completing tasks. The finality of planning is shown in a targeting “plan”, which is prepared for three – five years (strategic plan), preceded by action plans (on short term – one year and very short term), aiming to reach the lines of the strategic plan, customizing organizational and personnel actions, for each activity, the management having the role to harmonize long-term objectives with short-term ones, in order to make a profit. *Organizational plans* are also used, their objective being the survival on the market and the public image of the company, *the functional plans*, concerning actions for the development of the company, its product portfolio, and profit.

The planning stages in an insurance company comprise: determining the mission; developing strategies; setting long-term and short-term objectives; the preparation of the budgets; setting policies and preparing operational procedures.

- *The strategy* defines the selected action course and it should be compatible from one period to another, to be prepared in writing, to involve all those aimed in achieving them.

- *Forecasting* sets the strategic objectives, starting from knowing the current situation and projecting the future situation under the same terms, it *expresses assumptions*, based on the information from the internal and external environment of the company.

- *Allocating budgets*, which is the remuneration of those involved in the completion of the actions, including setting policies and procedures for the completion of the activities.

Implementing the plan, which is the responsibility of managers, while the *control* of the planning activity is made based on the analysis of the plan implementation reports. *The budget as planning tool* in an insurance company starts from the amount of the collection of insurance premiums, (the sales budget), cost estimation (budget of expenditures), according to the type and volume of the concluded insurance policies, the period for which the assessment is made, and which can be corrected during the completion of the activity.

b) Peculiarities of the organizing activity of insurance companies, defined by: the organizational structure, defining relationships within the company, clarifications for each position. *The organizational structure* is made according to Peter Druker’s concepts on: the analysis of the activities; decision analysis and relationship analysis.

Depending on the complexity of the activities, the delegation of the responsibilities is made, the hierarchical, functional, or hierarchical and functional structure of the insurance company is established:

- *the hierarchical structure* has the advantage of simplicity, ease of assessing performance, and it provides the increase of the decision-making process;

- *the functional structure* has the advantage that the company is organised around specialists on fields of activity, but requires the existence of a very good communication among them;

- *the hierarchical and functional structure* has the advantages of the two aforementioned structures, but at the same time has the disadvantage that the specialists tend to take over the management in the hierarchy, or are neglected by their superiors.

c) *The managerial peculiarities in the management of human resources* are defined by the decisive role of the subordinated staff, and include: planning the requirement, recruitment and professional training.

d) The managerial peculiarities of the activity include the guidance and supervision of the employees, in order to achieve the objectives, they are actually the finality of the other managerial activities, including activities associated to the management function, namely: delegation of the authority, motivation, coordination of the activities, mediating conflicts and the management of change, and managers have a special role in training and promoting employees.

The analysis of the results is based on insurance indicators and financial indicators, compared to those provided in the budgets, the causes that generated them are defined, and deviation correction methods are set. The responsibilities for the achievements are set down to the employee level, using the self-assessment and the assessment by the manager.

The reward is found under various forms from one company and can be practiced by salary increases or fees, or by the public recognition of the merits and other forms.

e*) The influence of risk on the managerial activity in an insurance company*

Some authors (Constantinescu, 1988) support that risk is part of the economic and social life, and can be found in the form of commercial risks, financial risks, social risks and production risks. The occurrence and action of risks is influenced by subjective factors that depend on the intention of the entrepreneur, and on objective (pure) factors that do not depend on the human intention and activity, which in recent decades has followed three trends, namely: the increase in a special pace of the risk and uncertainty cases; the increasing use of the resources of science to study risk in the social and economic system; the increase and diversification of the consequences generated by the risk analysis application and techniques in the social environment, in nature and at the level of each business entity.

Table 1. Agents that generate "other risks"

AGENTS APPELLATION	THE EFFECT PROPAGATED BY THESE FACTORS	OTHER RISKS
Market economy and its specific laws (competition, insolvency)	Adopting group strategies Apparition of some financial difficulties in companies where the social capital was subscribed	Participation risk
Market economy and its specific laws (competition, insolvency)	Appearance of insolvability state in some partners	The risk related to guarantees given to tertiary person
Unsecure financial markets Cyclic character of economy	The demand is dropping in the insurance market Some insurance policies are Annulled	General business risk
Shortage in educational system	Reduction in the quality of professional training	Managerial risk
The diminish of attention given to ethical values	The diminish of responsibility spirit and showing lack of confidence	

Source: Coană Rodica-Viorica,

Influence of adjacent insured risks upon the management of insurance companies (*The Bureau of surveillance for insurance activities, Study regarding surveillance in insurances, internal use, Bucharest 1997, page 6) http://www.financejournal.ro/fisiere/revista/1713202390FPV07_26.pdf*

The risk assessment in insurance is closely related to the identification of the exposure to risks and implies: identifying the goods exposed to risks; the identification of risks that can cause damages; the assessment and commeasuring of the effects of the manifestation of the risk, which can be physical; functional, or financial.

Insurance companies nowadays use modern risk identification methods, such as: the *process mapping method*, which is based on the analysis of the processes in the business entities, *the process map*, which is a diagram that reveals the exposures to risk factors, of the production means, participating goods and people who must be protected by the insurance, *the process diagram*, which details the processes and identifies the key components in the completion of any process, namely: inputs, outputs, restrictions, resources, *the assessment of the priority of the risks*, depending on their importance, the probability of manifestation of incidents with serious consequences. The technique implies: the identification of the event; the likelihood of its occurrence; its effects; the number of affected people; risk assessment; classification and review of the solutions.

Risk assessment in life insurance has a special role, because depending on the insured risks, the insurance premiums will be set and quantified. The assessment comprises the policyholder's obligation to disclose to the insurer any pre-existent health problem, the age and health condition when the insurance is concluded, the insurance term.

Risk management implies knowing the

environment of its manifestation, macro or micro economic, of the role of the risk in the economic and social life and must include actions recorded after the occurrence of the event, with a special role in the improvement of the measures and projects.

The practical methods of reducing risk in insurance companies comprise: reinsurance; hedging strategies; the transfer of part of the risk to various business partners.

Risk management in insurance companies is a process of identifying, analyzing and answering to potential risks of an organization, and once the risk is undertaken risk, the manager can take steps to: avoid risk; alleviate or minimize the effects, or transfer the risk.

The risk management plan includes*: the identification of risks, their assessment, setting their hierarchy, preparing the risk response plan; risk monitoring and control*.

The implementation of the risk management techniques implies making decisions concerning the risk coverage, if it is kept within the company, if self-insurance is used, or if the risk remains uncovered, and the damages are to be recorded as operating expenses.

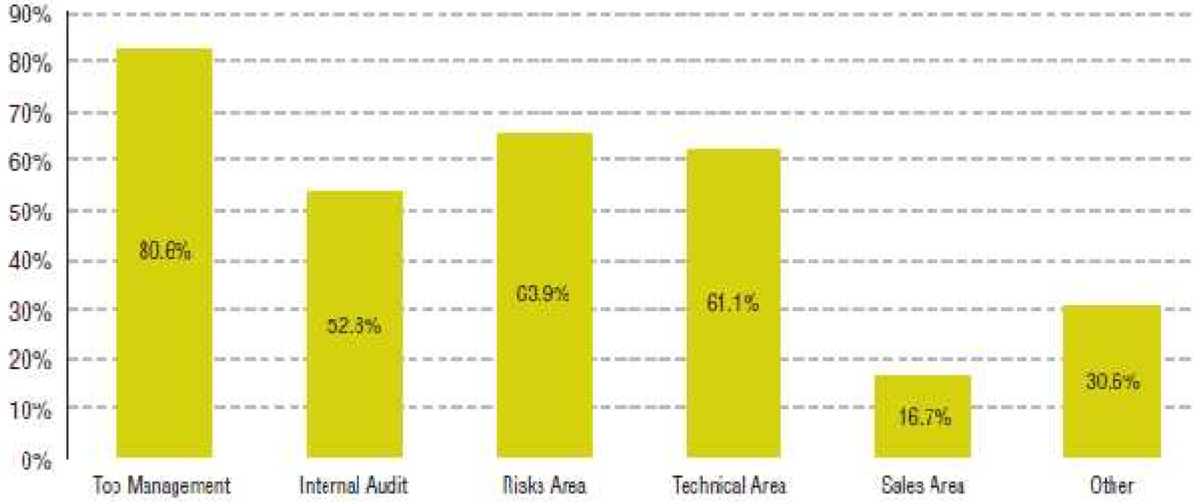
The regulation of the risk management in the insurance companies is made by *orders and norms* of the Insurance Supervisory Commission and involves making decisions regarding, hedging, while the strategic target is represented by the optimization of the business of the company.

The basic principles of risk management within a company are based on a common understanding of risk and define: top management responsibility for the company's risk strategy, separating of the risk management and control function, business management; defining the organizational structure and the responsibilities; the use of a single method of measuring and assessing risks; the consistent and effective monitoring of all quantifiable risks within the company; constant reporting and communication of risk, to all the relevant levels of management, creating the basis for a functional management; and the comprehensive and timely documentation in order to provide clarity and transparency.

Fraud and risk of fraud in insurance - fraud is defined by the International Association of Insurance Supervisors as: "an act or omission intended to gain dishonest or unlawful advantage for a party committing the fraud or for other related parties". Fraud is prevented through *policies, procedures and preventive inspections,* by applying a related management

According to a study (Everis, 2009) the responses of the different companies, the information generated by the tools is mostly used by Top Management in 80.6% of cases. In the Risk, Technical and Internal Audit areas, the results are very homogeneous with 63.9%, 61.1% and 52.8% respectively. When analyzing the responses by geographical area of the company interviewed, it may be concluded that in Europe, the areas that mainly use the information generated by such tools are Top Management (84.2%) and Risk Area (68.4%), which evidences that risk control information is another parameter for the decisions made by the higher management tiers of companies. In Latin America, even if Top Management is the most intended user of such tools, the percentage of companies whose top management uses such information decreases (76.5%). It should be noted that the Commercial area in Latin American companies is a significant intended user of such information (almost 30%), as opposed to European companies (5.3%).

Chart no.1. Areas of the company which mainly use the information generated by risk control tools, by business volume of the company interviewed

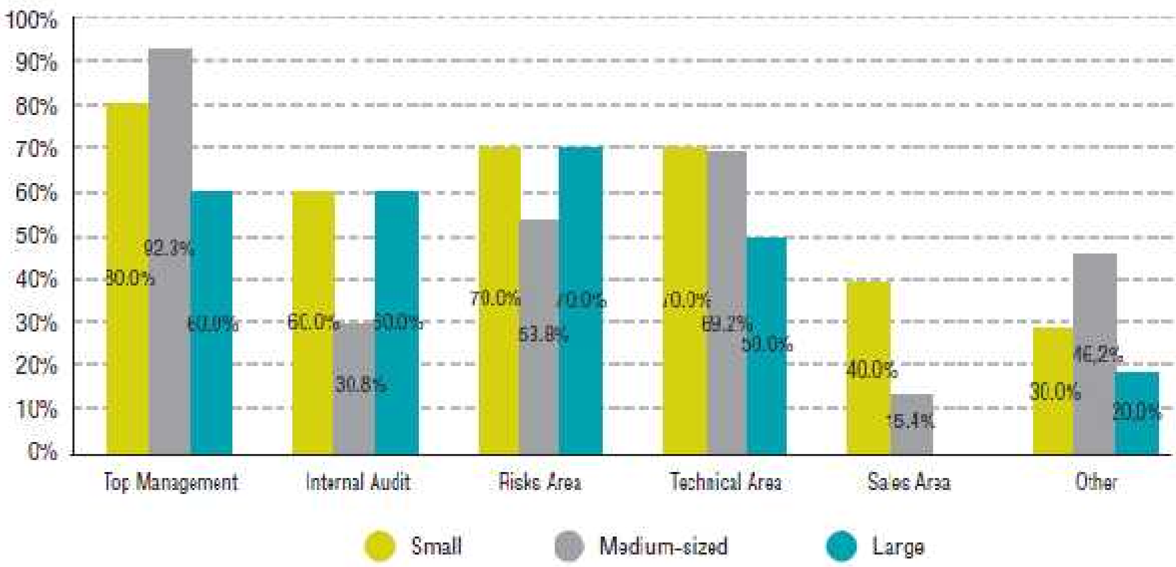


Source: Everis, Risk Management in the Insurance Business Sector, available to http://www.everis.com/global/WCRepositoryFiles/Study%20of%20Risk%20Management%20-%20sept%2009.pdf

From the analysis of the responses by business volume of the company, it can be noticed that the main intended user of the information generated for medium-sized and small companies is Top Management. However, the main intended user in large companies is the Risk Area. 90% of these companies, as per Graph 67 on page 72, have an independent risk area.

When comparing the responses according to whether the company is listed or not, it can be noticed that the main intended user in listed companies is the Risk Area, while in unlisted companies it is Top Management. This information is aligned with the organization strategy of companies, since 100% of listed companies had an independent area for risk control.

Chart no.2. Areas of the company which mainly use the information generated by risk control tools, by business volume of the company interviewed



Source: Everis, Risk Management in theInsurance Business Sector, available to http://www.everis.com/global/WCRepositoryFiles/Study%20of%20Risk%20Management%20-%20sept%2009.pdf

The questionnaire used for the study was sent to several companies of the sector in the Iberian Peninsula and Latin America. The number of participating companies is quite similar between both continents; Iberian companies account for 55.26% of the total, while Latin American companies make up the remaining 44.74%.

3. CONCLUSIONS

Risk insurance in a modern economy is a complex activity that interacts with many aspects of people's lives. The importance of the insurance industry for an economy can only be partly measured by the absolute measure of its activity, the number of employees, managed assets, or its contribution to the national GDP.

The paper reveals that the specificity of insurance determines an organization on several levels of the insurance company (territorial network, insurance portfolio, asset management, etc.).

However, there are a number of factors that should be optimized: providing insurance services at much higher standards, increasing the efficiency of the damage settlement process, releasing new products, adapted to the market requirements and, of course, a permanent investment in the improvement of the relationship with the brokers and with the other partners.

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