Personnel Risks Faced by the Insurance Industry

By Sara Schumacher

The insurance industry is not immune to personnel risk. With an ever-changing and volatile job market, coupled with rapid technological advancements and other factors, most notably COVID-19, this risk is becoming more prevalent and cannot be ignored as part of current regulatory examinations. Personnel risks can be different for each company depending on various factors such as type of insurance written, business model, local job market and upcoming changes for the company.

While many personnel risks may not be viewed as traditional solvency concerns, it is essential for management, examiners and analysts to be aware of how these risks could adversely impact a company. Examiners should take this risk into consideration when reviewing areas such as corporate governance, fraud, segregation of duties or other internal controls and identification of key functional activities. If pervasive throughout an organization, the examiner may need to increase the overall risk profile.

This article will provide an overview of the job outlook for the insurance industry. In addition, the article will discuss some best practices to assist examiners and analysts in the identification and assessment of the specific personnel risks being faced for the company under surveillance. Based on this job outlook and other factors, the article will present some personnel risks examiners and analysts should consider during future examinations and/or when updating their branded risk assessments.

Job Outlook for Insurance Industry Prior to the Impact of COVID-19- Great for Employees, Not So Easy to Manage

The following highlight several job outlook trends prior to COVID-19:

Availability of Experienced Workers

Insurance companies continue to experience difficulties filling job openings with experienced personnel. This can occur at all levels (not just Executive Management) and within any department at an insurance company.

- Per the first quarter 2020 iteration of the Semi-Annual US Insurance Labor Outlook Study, “the insurance industry remains in a candidate driven market with a nearly non-existent unemployment rate.”
- The Finance and Insurance Industry has been continuing to increase its workforce. This is evidenced by various statistics from the United States Bureau of Labor and Statistics:
    - The continued increase in the average job openings from 108,000 in 2009 to 261,000 in 2019.
    - The increase in the number of employees in the Finance and Insurance Industry from about 5.76 million employees at the end of 2009 to about 6.46 million employees at the end of 2019.
- The Finance and Insurance Industry continues to lose a significant number of employees each year as individuals from the baby boomer generation retire. This results in the industry running into difficulties with being able to replace experienced personnel not to mention the loss of historical knowledge as many of these individuals were with the company for decades. For instance, the number of employees hired over the last ten years in the Finance and Insurance Industry is only slightly higher than the number of separations over the last ten years, which was about 1,371,000 hires versus about 1,340,000 separations (The United States Bureau of Labor and Statistics).
- In addition, the availability of experienced workers can be impacted by position growth & decline and the implementation of new technology and/or other strategic changes.

Position Growth and Decline

Insurance companies may experience difficulty filling certain positions given projected growth by 2028 or may need to consider reorganization of their personnel given projected decline in some positions by 2028. The average projected employment growth rate is about 5-6% by 2028. Below is a summary of some positions on the rise and decline by 2028 per The United States Bureau of Labor and Statistics:

- The most significant growth will be Information Technology positions. Some of the top growing occupations by growth rate include:
  - Information Security Analysts 32%
  - Software Developers/Applications 26%
  - Computer and Information Research Scientists 16%
  - Web Developers 13%
  - Computer and Information Systems Managers 11%
  - Computer Support Specialists 10%
  - Computer System Analysts and Database Administrators 9%
- Market Research Analysts 20%
- Financial Managers 16%
- Insurance Sales Agents 10%
- Financial Examiners 7%
- Accountants, Auditors, and Financial Analysts 6%
- Insurance Underwriters 5% decline
- Claims Adjustors, Appraisers, Examiners and Investigators 6% decline

Implementation of New Technology and/or Other Strategic Changes

Insurance companies continue to adopt new technology, replace legacy systems and/or change their strategic plans. This is done for a variety of reasons to ensure, among other things, policyholder and/or shareholder expectations are met, to remain competitive, adapt to business disruptors or other reasons. These changes can influence an insurance company's personnel differently such as:

- There could be a need for a new skill set or experience not only to implement the new technology, but to operate the technology, to complete maintenance and/or to make updates.

- Many times, companies may also need to retain individuals that can run out business on their legacy system, which requires personnel to ensure these legacy systems are maintained until fully obsolete.

- Certain positions or duties could become obsolete as technology is now performing these functions and/or the function is no longer necessary. Examples could be big data and/or artificial intelligence that can perform these functions such as the completion of reconciliations, automating the underwriting process, and/or identification of potential fraud.

- The organization may need to be re-organized to suit the new strategic plan. Many companies are adapting to new generation of consumers' demands, not to mention the impact of COVID-19. One such example is the implementation of mobile apps to be used by the customer. The banking industry was one of the first to implement this option so individuals with past experience on this implementation were recruited heavily by some insurance companies when implementing these mobile applications for their company.

Increase in Labor Costs

The Finance and Insurance Industries continue to experience an increase in cost of compensation for employees due to the need to compete for experienced workers, the increase in the cost of healthcare, and other factors. The United States Bureau of Labor and Statistics estimates the cost of total compensation per hour worked has increased from $39.19 at the beginning of 2009 to $54.48 by the end of 2019 or about 39% over the last ten years. This is expected to continue given projected increase in costs for employer healthcare on average is expected to grow 6% in 2020 and increases in order to compete for certain positions.

Job Outlook post COVID-19 – Uncertainty but Instable

Much like the rest of the industries, insurance is not immune to the impact of the coronavirus. While many of the previously discussed personnel outlook trends will likely continue, there is also much uncertainty as the insurance industry will need to respond to the impact of the COVID-19 over the next couple of years due to declines in premiums, rises in costs, changes in regulations, economic changes and other factors. The following is a brief update on the Job Outlook for the Finance and Insurance Industry at this time. The outlook is likely to change as the impact of COVID-19 continues to disrupt the Insurance Industry and may be more or less applicable depending on lines of business being written.

Per the Third Quarter US 2020 Semi-Annual US Insurance Labor Market Outlook Study, the initial results are the insurance industry has remained relatively stable in the insurance labor trends during COVID-19. The recent study released indicates about 48% of companies anticipate increasing employees, 35% of companies expect to maintain employees and 17% anticipate decreasing employees. Insurance companies anticipate offering flexible work options even once offices re-open which includes increased ability to work from home, flexible hours and full-time remote.

There are reports estimating eight of eleven functions have experienced increased difficulty in recruitment, especially Actuarial, Technology and Analytic positions. Respondents indicated:

- Technology and analytics roles are expected to grow the most.
- There is a need for Underwriting Executive talent.
- Entry level positions are anticipated in operations and actuarial areas.
- There is likelihood of understaffing given anticipated increases in business volume.

The Second Quarter US 2020 Semi-Annual US Insurance Labor Market Outlook Study had a mixed bag of results as some companies were hiring, some companies were still evaluating their hiring plans, some initiated hiring freezes and some companies were slowing hiring due to COVID-19 but no significant layoffs were noted. The companies noted plans to add full time technology, analytics and claims personnel but also plans to use temporary staffing during the pandemic. The increased in claims staff was not unexpected given increase claims for certain lines of business.

While rumors abound about potential layoffs, furloughs, and cuts in compensation for companies, the only insurance company in the news so far seems to be Aon, PLC (Aon). There has been several announcements regarding changes in Executive Officers and Directors.

- In April 2020, "Aon announced it will temporarily cut the pay by 50% of the company's named executive officers in response to the COVID-19 crisis. In addition, 70% of its global workforce will see a 20% reduction in their salaries, while approximately 30% of Aon colleagues will see no reduction" (Howard).

- Effective July 1, 2020, Aon reversed the decision and will pay in full any reductions to salary for its employees plus 5% of the withheld amount. The reductions remained in place for executive offers and board members in addition to some other cost cutting initiatives (Nadeem).

The Finance and Insurance Industry is experiencing fluctuations as 2020 continues and is evidenced by various statistics from the United States Bureau of Labor and Statistics such as:

- The gradual decrease in the average job openings from 231,000 at the end of 2019 to 345,000 in January 2020, 289,000 in February 2020, 246,000 in March 2020, 210,000 in April 2020, and 185,000 in May 2020. There was a preliminary estimate of an increase in 217,000 job openings in June 2020.

- The number of employees in the Finance and Insurance Industry is staying pretty stagnate as was about 6.46 million employees at the end of 2019 to ranging from 6.44 million to 6.55 million in 2020.

- The unemployment rate was 2.0% for experienced finance and insurance personnel at the end of 2019 and has averaged about 2.8% in 2020 ranging from low of 1.8% to high of 3.8%. The unemployment rate for August 2020 is 3.1%.

- The estimate for new hires in June 2020 was 158,000 which was up about 10,000 from average for June the prior ten years. The beginning half of 2020 was marked by new hires for each month exceeding the average for the prior ten years apart from May 2020.

- The average number of separations was above the average for the prior ten years for January to March 2020 and was below average for April to June of 2020.

As other industries let personnel go, opportunities may present themselves for insurance to acquire this talent. These individuals may likely need to gain more knowledge and/or experience specific to insurance, however it may be a gain due to their past specialized experience or skills transferring over (i.e. IT, finance, investments, etc.).

How to Identify Specific Personnel Risks and Stay up to Date on Insurance Personnel Trends

Examiners and analysts should assess the risk that is appropriate for the Company and the Industry overall. Following are some best practices to help identify personnel risks and risk mitigation strategies.

<u>C-Level Interviews and/or Discussions with Management:</u>
One of the best approaches to identify potential personnel risks specific to a company is through C-level interviews. In formal and informal discussions, management is in my experience usually pretty forthcoming with state departments on open positions, personnel risks, and personnel plans. Many times, a transparent relationship between company management and department personnel, leads to greater transfer of information that may not fully be known internally and/or to the public.

Examiners and analysts should not be afraid to ask frank questions about open positions, need for certain experience or skill sets, succession planning, hiring issues or training initiatives. In past examinations, this has allowed for prospective risks to be more specific to a company and for examinations to focus on key areas or risks that may be significantly impacted due to individuals performing dual roles, significant turnover in an area or other factors.

As an example from a recent exam I worked on, there were several late and/or inaccurate filings by a company. Once the issues were discussed with different members of management and personnel, it was determined that the cause was likely due to significant turnover in key areas like accounting along with changes in responsibilities between departments. Past personnel had been with the company for decades and responsibilities of each employee were not always clearly defined in writing. As a result, the new personnel did not know the extent of their duties and responsibilities resulting in certain required filings not being completed timely and/or accurately. It took time to train the new employees to the full extent of responsibilities and required an examination to determine the overall reason for the issue. Once the reason and overall issue was fully known, the company implemented a filing checklist to ensure everyone knew the individual/position responsible for each filing and then set up reminders to ensure timely review and submission.

<u>Strategic Plans:</u>
Personnel risk can change in concert with strategic plans. Be cognizant of new strategic initiatives and personnel resources required to achieve them.

The recent move by the insurance industry to implement new technology and/or to offer digital options for agents, policyholders, claimants or others has resulted in an increased need for IT personnel with specific experience either in implementation and/or upkeep. It can also result in restructuring and/or terminations as some positions may become obsolete resulting in re-training of employees to work in different positions or to take on different responsibilities.

Another trend that is likely not to change any time soon is employees working from home. Many companies are reporting plans to continue remote work even after COVID-19 either on a permanent basis, temporary basis and/or as part of the business continuity and/or disaster plan. The impact of increased personnel working from home likely could result in a whole article all on its own given:

- The new risks faced for the company by working remotely;
- The increased risk assessment for certain branded risks areas;
- The increased need to be able to troubleshoot tech issues remotely;
- The increased need to electronically communicate through phone or teleconference (i.e. virtual conferencing);
- The increased potential for fraud, privacy compliance, data security and cybersecurity concerns and;
- The potential impact on internal controls in addition to how to test/monitor that internal controls are working as designed and effectively.

Given the recent trial by fire as a result of COVID-19, examiners and analysts can likely gain an understanding of what worked well, what issues arose and what changes a company may be making before transitioning from a "temporary" work from home model to the new long term strategic plan for working from home option for employees. This likely could be one of the many COVID-19 topics/questions examiners and analysts can include in the C-Level Interviews. For examinations, this could impact the areas of focus and/or identification of specific risks especially surrounding the IT Review, internal control testing/walkthroughs, fraud factors to address, market conduct concerns and other aspects.

Organization Charts, Risk Repository, Budget and Other Filings:

As a best practice, it is helpful to have a copy of the current organizational chart to compare to the one used in the prior exam to gain an understanding on changes in personnel and/or overall organization. Many times, the current organization charts will provide information such as vacant positions and dual positions held. When comparing the two charts, examiners can get a true feel for the amount of turnover and/or changes in the organization structure.

Companies usually only report turnover in executive management and/or the Board of Directors in Exhibit B or Exam Planning Questionnaire and/or notification of changes to the state departments. This sometimes results in examiners and analysts not being fully aware that the underwriting department fully changed since the last exam so then may want to focus some more attention to this area in Phase 1 to determine if there is a need to include specific risks and/or maybe raise risk assessment for underwriting key risk area.

In the past, it has been beneficial to have a copy of the organization chart (current and past) when discussing the changes with the head of the department during the C-Level interviews. Management may at that time be able to provide a more complete picture and reason for the changes. They may also provide an overview of mitigation measure put in place while there are open positions and/or individuals performing dual roles.

Generally speaking, all companies should have some type of risk regarding personnel in their risk repository, whether considered significant or not. The risk could be specific to the company and/or insurance industry overall. If they do not, examiners and analysts should likely follow up on why as it may indicate management is not aware of the current job market trends.

Management should also be able to demonstrate its awareness of the current job market and/or compensation trends given the importance of retaining experienced personnel; being unable to do so may indicate they are not appropriately budgeting for future costs or providing adequate training or taking into account work-life balance considerations.

Industry Developments:

Significant changes in hiring, terminations, retirements and/or changes in compensation generally make the news for larger insurance companies. It would be beneficial to monitor the news for any specific changes to the company. It would also be good to monitor the overall job trends for the insurance industry. These changes should be considered when monitoring and/or examining companies in the future.

Some good monitoring sites are S&P Global and the Jacobson and Aon U.S. Insurance Labor Market Outlook Study. Individuals can set up email alerts on their websites for areas of interest specific to companies and/or the insurance industry as a whole. The Jacobson and Aon Outlook study is an online survey completed by management at their discretion, which includes key questions on job outlook specific to the insurance industry.

Company Website/Job Postings:

Many larger companies have job listings right on their websites that includes how long positions are open. These open positions and length of time opened could provide some insights in questions to ask management about turnover, open positions, higher risk areas/departments, or what management is doing to fill these positions. One company had job postings for middle management that had been open for months, which led to higher risk of fraud as there was less segregation of duties.

Employee Surveys and/or On-Site Visits:

The overall results of employee surveys could identify overall morale issues amongst employee. Low morale may be due to rate of change, planned restructuring, fear of changes as a result of COVID-19 or other. It may be good to review the surveys if examiners identify a potential morale risk.

In one past exam, almost the entire management team had changed due to retirements and change in the Chief Executive Officer. The CEO was making numerous changes. This made us wonder could they lose their personnel as a result of the all the changes going on. The surveys were anonymous and helped us to get a sense that employees accepted the changes as were well informed by management of not just the changes but also the reason for the changes. This resulted in employee buy in and excitement for the changes. While the company lost some personnel, it was not significant when compared to overall turnover rate for the industry.

Another method to identify personnel risks can be through general atmosphere and/or mood of employees as experienced first-hand when on site. Usually you can get a sense of company morale just from seeing the overall atmosphere of the company.

<u>Additional Personnel Risks to Consider:</u>

Examiners should consider expanding their personnel risks outside the generic *the Company is not implementing appropriate succession planning at the Executive Level.*

The list is not all inclusive as it should be modified to suit each specific company.

- The Company's is unable to retain and hire qualified personnel or is unable to compete to retain and hire qualified personnel.

- The Company is experiencing difficulty filling specific vacancies especially in IT, Insurance Sales Agents, Market Research Analysts or others.

- Management is not managing the pace of change (such as implementation of new technologies or other strategic changes) to match their personnel's tolerance level.

- The Company is not appropriately budgeting for compensation and recruitment costs to retain and hire qualified personnel.

- Management has not implemented appropriate programs to mentor and train employees especially as hiring more personnel without and/or with less of an insurance background.

- Management is not knowledgeable about job trends and their competitors' recruitment or compensation practices resulting in loss of experienced personnel.

- The Company's business continuity plan needs to be updated based on negative issues experienced during the stay at home orders due to COVID-19.

- Personnel morale is low or there is increased risk of fraud due to layoffs, furloughs or salary cuts due to COVID-19.

- The Company has not appropriately improved its IT or other business operations due to change in its model from working in the office to have individuals work from home.

- The Company's operations are significantly impacted as unable to have employees work remotely.

For consideration, identified personnel risks may need to be viewed for what the overall impact could be for the company. For instance, lack of personnel, morale issues or other personnel risk could cause:

- The overall corporate governance assessment to be weaker.
- These could be identification for potential fraud factor that needs to be considered in the branded risk assessment and/or during the next examination.
- It could cause lack of segregation of duties or other internal control issues.
- It may help identify some key risk activities for examiners to focus on during the next examination or could increase the overall risk assessment for the company and/or specific branded risks.

<u>Closing Remarks</u>

This article only presents certain personnel risks being faced by the insurance industry and some best practices to identify and test the personnel risks identified. Examiners and analysts should be on the lookout for other personnel risks throughout their surveillance cycle and document any risk to be specific to the company being examined as it may increase risks for other areas.

About the Author

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Sara has over 9 years of experience in the regulatory insurance industry. As an Examiner-In-Charge and Senior Examiner, Sara leads and assists on financial and market conduct examinations of insurance companies on behalf of state insurance departments.

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