The opportunity for the finance function in insurance

The global insurance industry is facing a surge of change in almost every aspect of its business. At the heart of the transformation lies the finance function, which has now reached the stage where the traditional approach of incremental, short-term solutions and workarounds is no longer enough, and fundamental underlying issues around data, systems, models, processes, and people have to be addressed.

Over the past decade, the landscape in which the global insurance industry operates has changed dramatically, and the pace of change continues to accelerate. New and wide-ranging reporting standards and regulations are driving a more precise assessment of performance, more detailed disclosure, and speedier reporting. The need of boards and management for more timely, accurate, and detailed information, on actual and projected revenue as well as the balance sheet, is increasing to support decision making in an environment of scarce capital, an intense focus on risk management, and more explicit accountability for board members. But at the same time, industry consolidation and restructuring have increased the complexity of many firms, making it more difficult to provide the management information required.

On top of this, social, economic, and environmental mega-trends are driving further change in the insurance industry. These range from extended life expectancy to increasing urbanization, from more extreme weather events to greater use of social media, and an increasingly interconnected world.[1]

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As if this is not enough to cope with, the industry also has to address the reorientation of economic growth and business opportunities toward new markets in Southeast Asia, Latin America, and Africa, as well as the challenges of historically low interest rates and volatile equity markets.

To survive and comply in this highly regulated, uncertain, and fast-moving world, insurers have to become more flexible and efficient. If firms do not change proactively, change will be forced upon them. We have seen how Solvency II is already driving change in the European insurance industry – especially in the life sector. But increasingly, we will see these other drivers having similar impacts in both the life and nonlife sectors around the world. The secret is to make sure the changes that are required to systems, processes, and people are not just about compliance, but also about cost optimization and competitive advantage.

Transforming the finance function

Finance functions in particular will have to deliver more with less. But here the opportunities are clear. Finance processes for insurers, particularly in the life sector, have historically been convoluted. There are large volumes of complex policy data sets, processed across multiple systems and platforms which—at least outside Asia—were typically built pre-2000. These systems generally lack flexibility. Also, they do not deliver information across the required reporting bases at the level of detail required to enable finance to provide the analyses and insights to support fast, accurate decision making.

Typically, accounting and actuarial teams have operated in silos, with the accounting teams having little involvement in the calculation of technical liabilities, and the actuaries being subject to limited challenge. More often than not, incremental changes in internal or external reporting, new acquisitions, or restructuring have been met by complex, ingenious short-term solutions, usually based on spreadsheets, which were layered on top of the underlying systems and even on top of earlier workarounds.

The problem today is that while each solution no doubt once made sense as a quick, cheap response to an immediate need, overall they have led to an IT systems architecture that is poorly documented, incredibly complex, and therefore difficult to understand, control, or change. With a system like this, generating reliable figures can be time-consuming, involving considerable manual intervention and multiple rounds of iteration, reworking, and checking. Such a clumsy piecemeal approach is ill-suited to the changing world of insurers (especially to compliance with demanding new regulations like Solvency II), and costly and inefficient use of people and their time.

Many organizations are revisiting their systems architecture because the regulatory requirements for data granularity and control and for reporting deadlines are impossible to meet with the current approach. However, while creating a 'state-of-the-art' systems and data architecture initially appears attractive, in reality it is not usually the deliverable or what end-users really require. To achieve a manageable and practical solution, companies need to address issues and seek potential data and systems solutions in light of clearly understanding what capabilities the finance function really needs. They can then make informed judgments about what systems are 'fit for purpose' and have long-term architectural integrity.[2]

Addressing people issues

But this is not simply a matter of addressing data, systems, and processes, because these are developed, operated, and managed by people; and many of the behaviors that characterize the culture of insurance organizations are inconsistent with the new demands for urgency, flexibility, detail, and transparency.

For example, traditionally actuaries were seen as a breed apart; there was limited interaction between them, accountants, and other professionals, and limited demands as to the speed, quantity, and quality of reporting. A further people issue involves key man dependency. The complexity of systems, the proliferation of end-user solutions, the extent of data, and modeling issues have all led to a heavy reliance on individuals with expert knowledge to run processes and to review and validate results.

Such a fragmented and siloed approach cannot meet today's demands for high-quality, efficient data input, analysis, and

[1] For more on mega-trends and IT, see the article on *Technology and intelligent insurance*, December 2012.

[2] For more on IT systems, KPMG, *Data and Systems: It's a journey not just a destination*, October 2012.

reporting. This requires financial and other professionals to work closely together using common data and integrated systems. But achieving this will require a major program of culture change, because these traditional ways of working – and the status they confer on key players – are deeply embedded. Resistance can be expected to any changes that are perceived to undermine a person's authority by removing the organization's reliance on their unique expertise.

So the changes required are not just in data, systems, and processes – the insurers' equivalent of a global Enterprise Resource Planning initiative. People will have to change, learn to work as part of a team, and have confidence in the figures the new systems provide. Cost savings will only appear if firms move from double and triple checking each calculation to believing the numbers produced by the system, so that there is one reporting process and one set of numbers that is used by everyone, actuaries and accountants alike.

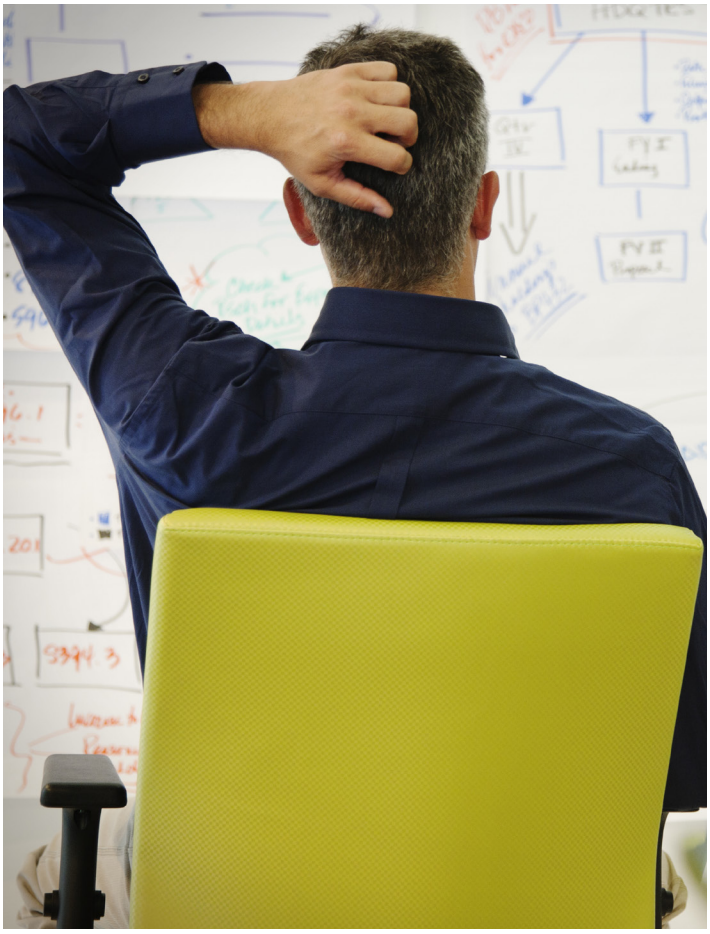
Why now?

An industry that has not altered that much in the past century is being hit by a tsunami of change involving different business models, more detailed information requirements, faster reporting, greater transparency around the quality of controls and decision making, new mobile and cloud computing, changing demographics…the list goes on. It is impossible to manage risk, extract value, and identify competitive advantage with the old, inflexible systems. They simply do not provide management information in the detail required for reporting or risk management, nor do they enable rapid 'slicing and dicing' of the figures, either in response to organizational, market, and regulatory changes or to look into alternative future scenarios.

The good news is that the required investment in new systems, processes, and cultures has a payback. By eliminating much of the existing need for manual intervention and the constant corrections, reconciliations, reworking, and checking, we believe finance operational costs can be reduced by up to 30 percent. At the same time, capital reserves can also be reduced significantly because of the lower operational risk. But arguably the biggest benefit is mitigating the risk associated with poor financial information, both internally and externally. Companies typically end up having to spend substantial sums of money to address these risks when they crystallize.

[3] Read more in – KPMG, *Insurance Finance Transformation: The business case for Insurance Finance Transformation*, March 2012 or visit the Web site.

In this uncertain world, the only certainty is that everyone will have to do everything cheaper. But there is no contradiction between improving the abilities of the finance function and delivering cost reductions. The coming together of numerous drivers of change—from mega-trends, to regulation, to the need for new business models—means that piecemeal enhancements are no longer enough. It is far better for insurance firms to meet the need for significant change head on and put in place the systems, processes, culture, and ways of working that will deliver sustainable business benefits and competitive advantage in tomorrow's world.



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