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Insurance

Finance Function Diagnostic for Insurance

2008 executive summary

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Dear Colleague:

As insurance executives face continued pressure in today's global business environment, benchmarking the performance of the finance function has become an increasingly valuable practice.

Measuring internal strengths and weaknesses, and comparing them against "best in class" performance of not only other insurance companies, but also leading performers in other sectors, can enable executives to identify and mitigate gaps that could hinder the performance of the finance function and the entire business, while simultaneously incurring unnecessary cost.

This report reveals how a cross-section of major insurance organizations compares to its peers in five key categories:

- Transaction processing
- General accounting and external reporting
- Financial controls
- Tax and treasury
- Performance management

Within each category, we show how the results of low-cost performers surpass those of both the insurance industry median and a median of non-insurance organizations, as well as the size of the gap between the top-quartile performers and the rest of the sample.

We hope you find the results of this study to be helpful and instructive, and invite you to contact our specialists for further information about our research.

Sincerely,

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Seeking a competitive edge

Overall opportunity is $7.4 million per $1 billion in total annual premium; 89% of this opportunity relates to process costs.

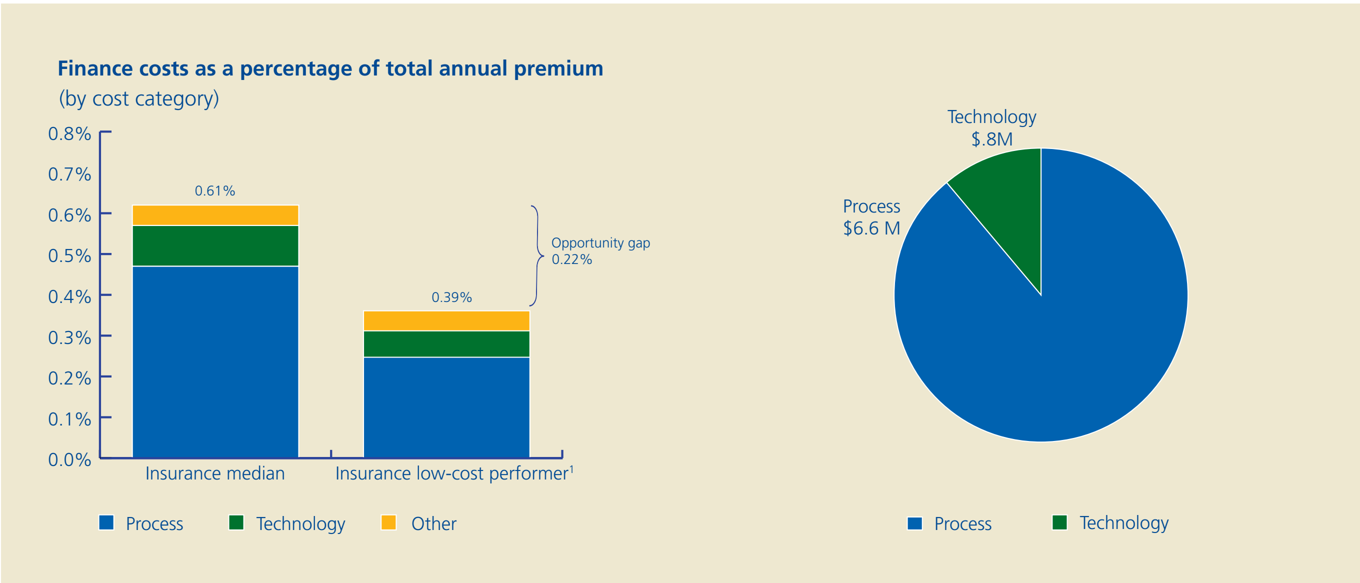

Figure 1.

> "Organizations benchmark performance for very tangible reasons. They want to manage costs, reduce spend, and increase efficiency and productivity. They also want to understand their position relative to their peers, find points of weakness, and identify opportunity gaps."

Like much of the financial services world, the insurance industry today is facing a competitive maelstrom.

Global competition continues its upswing, with significant pressure on margins from offshore providers. Speed and agility are critical dimensions of corporate performance, with tight cycle times for decision-making.

To cope with these and other forces, insurers are turning to benchmarking to identify leading practices that can help them improve and monitor performance of the finance function.

Organizations benchmark performance for very tangible reasons. They want to manage costs, reduce spend, and increase efficiency and productivity. They also want to understand their position relative to their peers, find points of weakness, identify opportunity gaps, and make improvements.

Executives expect access to relevant data to answer a host of questions: What are our greatest areas of strength? Of weakness? What gaps do we need to close, and how quickly? What are our competitors spending? How does that affect our spending decisions?

Benchmarking against leading performers both within and outside the insurance industry can help provide the answers to these and other questions. However, the answer is not always to be best in class – it's to find the right point on the scale that works for the organization, because being best in class comes at a cost.

Some organizations might strive to be best in class on cycle time for the financial close, but the cost of doing so might be prohibitive. Organizations need to strike an appropriate balance that aligns with organizational needs and requirements.

[1] As used in these charts, "Insurance low-cost performer" refers to the company at the bottom of the first quartile.

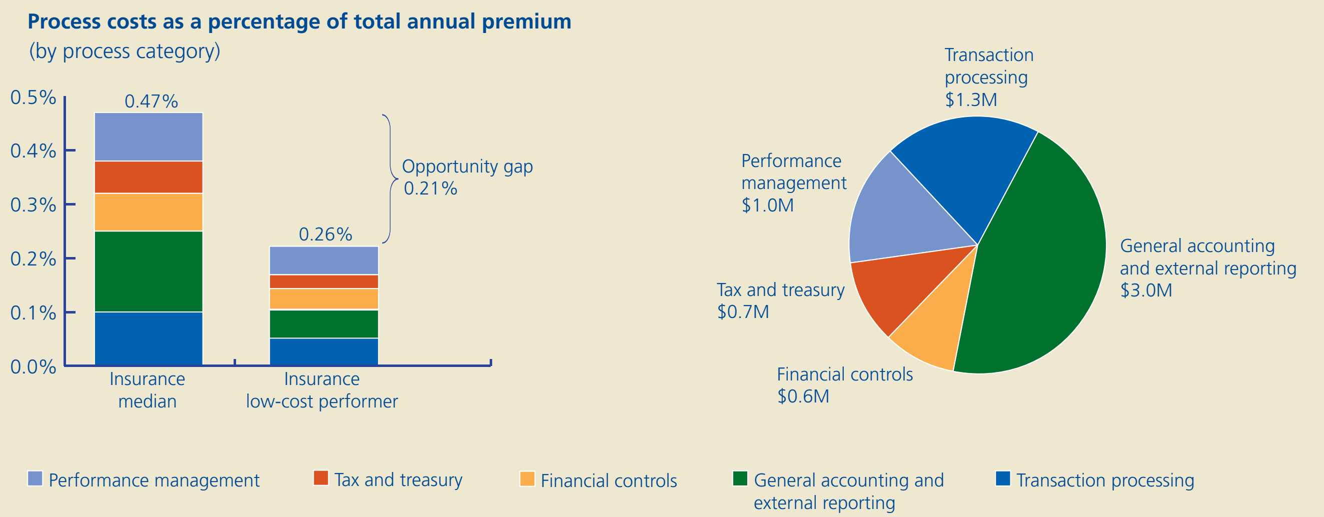

Figure 2.

A multi-million-dollar opportunity

The average overall finance cost savings opportunity for the insurance industry is $7.4 million per $1 billion in total annual premium (Figure 1). That's a comparison between the insurance median and low-cost performers. Thus, a $2 billion insurance company that is around the median has the potential of reducing costs by as much as $14.6 million.[2]

Total finance cost as a percentage of total annual premium is 0.61% for the insurance median, compared with just 0.39% for low-cost performers. The question facing most insurance organizations, though, is not how to get their percentage down to the 0.39% of the low-cost performers. It is how to determine what percentage is reasonable and achievable, and how best to reduce the opportunity gap.

Being a low-cost performer is not always the best option. It's a target, a place to go.

A high percentage (89%) of this opportunity gap lies in process costs – labor and outsourcing. The remainder is found in technology. Process opportunity is $6.6 million per $1 billion of total annual premium (Figure 2). General accounting and external reporting accounts for the largest slice of process opportunity, $3.0 million.

[2] The following definitions apply to this study:

"Low-cost performers" refers to insurance companies in the first quartile of the five process categories (transaction processing, general accounting and external reporting, financial controls, tax and treasury, and performance management).

"Insurance median" is the midpoint value of insurance industry participants.

"Median" is the midpoint value of non-insurance cross-industry participants.

Why it pays to be a low-cost performer

Analysis of benchmarking data across the insurance industry reveals a number of advantages that low-cost performers and larger companies enjoy:

- Low-cost performers cost 37% less than the insurance median, which nets $7.4 million per $1 billion in total annual premium.
- Larger companies have economies of scale with 20% lower costs.
- Larger companies spend 36% more on technology than smaller companies, driven by a better ability to capitalize on economy-of-scale opportunities.

Transaction processing

Low-cost performers spend 39% less in transaction processing than the insurance median.

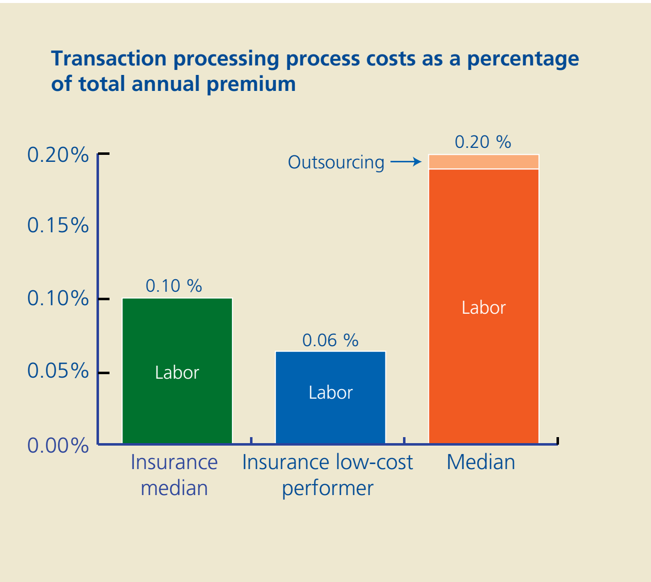

Figure 3.

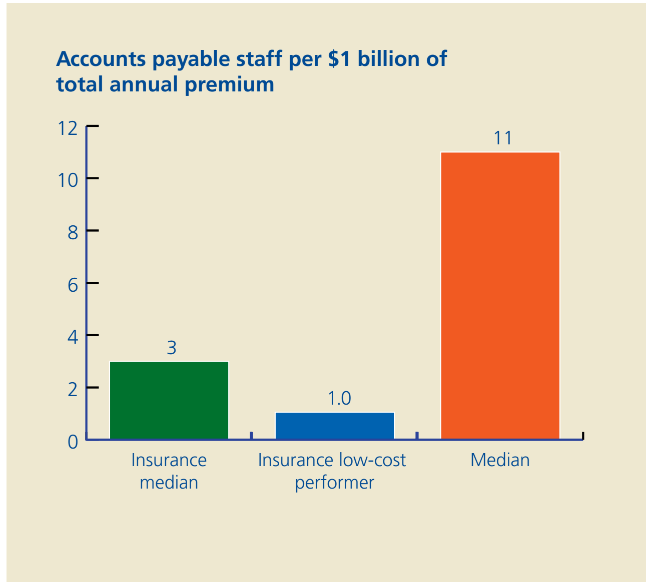

Figure 4.

"Low-cost performers integrate underwriting, claims, and policy administrative systems both horizontally and vertically within their organizations."

Although a relatively small slice of the overall finance function pie, transaction processing – which spans a variety of labor-intensive processes – offers meaningful opportunities for cost savings.

Low-cost performers spend 39% less in transaction processing than the insurance median (Figure 3). This equates to $1.3 million per $1 billion in total annual premium.

For the accounts payable process, low-cost performers are 69% more productive than the insurance median and have 60% less accounts payable staff per $1 billion in total annual premium (Figure 4). This does not necessarily represent a competitive advantage because manufacturers, retailers, and other companies that constitute the cross-industry median have significantly more throughput per $1 billion revenue and typically have a more complex accounts payable process.

Insurance companies at the vanguard of transaction processing follow a number of leading practices:

- **Technology** – Low-cost performers integrate underwriting, claims, and policy administrative systems both horizontally and vertically within their organizations. This enables them to leverage information management by creating data standards that centralize management and operational reporting from a data warehouse.
- **Organization and Talent** – These companies centralize back-office operations, either shared services or outsourcing, and define career paths for staff in these areas. This is critical due to the often repetitive nature of the jobs.
- **Policy and Process** – In addition, low-cost performers standardize transaction processing, and create and reference well-documented policy manuals.

Case study: Bringing transaction processing into the 21st century

The property and casualty division of a large, multi-line financial services company recently implemented major structural changes to its transaction processing systems.

The organization was struggling with manually intensive and poorly coordinated billing, accounting, and cash-related transaction systems and processes, which led to lengthy invoicing cycles, poor receivables management, and slow posting to the general ledger. Disjointed processes and hand-offs created the need for more robust controls.

To overcome these problems, the division developed and implemented a new, integrated financial system to connect the accounting and billing processes, redefined the associated business process and controls, and improved overall information flow and analytics. In addition, the division streamlined its operating model and launched a performance management program.

Significant benefits included: measurably improved cycle times; decreased manual effort; decreased error rates across billing, accounting, and cash-related transactions; reduced reconciliation activities; a stronger controls environment; and improved organizational readiness to support enhanced performance.

General accounting & external reporting

The gap between the insurance median and low-cost performer is $3.0 million per $1 billion of annual premium.

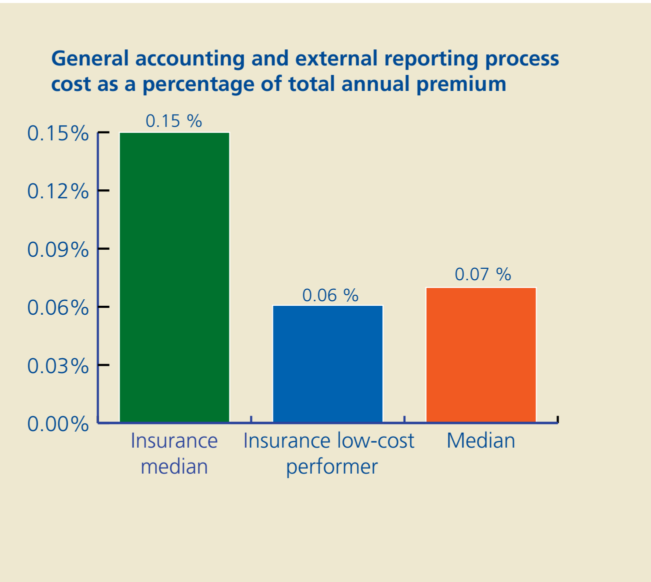

Figure 5.

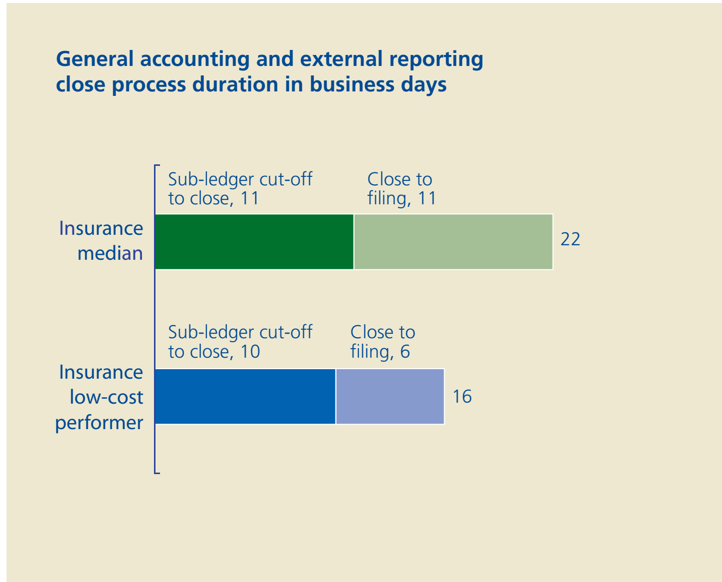

Figure 6.

> "The higher cost of the insurance median, when compared with the cross-industry median, may reflect additional statutory and statistical reporting requirements that the insurance industry has to bear."

Leaders among the insurance finance function achieve efficiencies in general accounting and external reporting by simplifying processes and leveraging technology. Such advances can yield significant savings.

The gap between the median and low-cost performers is $3.0 million per $1 billion of annual premium (Figure 5). Moreover, low-cost performers have 60% less staff than the median. The higher cost of the insurance median, when compared with the cross-industry median, may reflect additional statutory and statistical reporting requirements that the insurance industry has to bear.

Low-cost performers also close and report 27% faster than the median (Figure 6). These leaders perform fewer than half the number of account reconciliations and have 96% fewer manual journal entries than companies in the cross-industry median.

Insurance companies that set the pace for efficiencies in general accounting and external reporting observe a variety of leading practices.

- **Technology** – Low-cost performers tend to employ an integrated general ledger that cuts across legal entities. When disparate general ledgers are in place, companies may use a robust reporting and consolidation tool.
- **Organization and Talent** – To ensure that they have an adequate supply of talented staff, low-cost performers establish rotational programs that familiarize their people with key contacts and businesses, create cross-training opportunities, and reduce individual dependencies. In addition, these companies establish mini "centers of excellence" for GAAP, statutory, and statistical reporting. These core groups of specialized skills allow people to do their jobs more efficiently and provide organizations with a pool of back-up resources.
- **Policy and Process** – Low-cost performers define the core basis of accounting and reporting, and sequence the production of other reporting bases appropriately. They also define and adhere to appropriate materiality limits during quarter- and year-end closings. In addition, they use recurring and standardized journal entry formats/templates, and employ structured closing tools, such as accountable close calendars and daily conference calls.

Case study: Streamlining and automating the quarterly and year-end close

A large division of a major property and casualty insurance company recently improved the efficiency of its general accounting and external reporting processes.

The company suffered from a manually intensive and error-prone close process due to inefficiencies and lack of technology integration, which reduced the organization's ability to focus on value-added analysis and forced resources to be overtaxed.

By conducting an assessment of the close process, the company identified a number of improvements that they could implement. Key changes included the development of a detailed close calendar, highlighting all systems, information, and departmental dependencies and appointment of a "close champion" to manage the process; automation of many previously manual, recurring entries; movement of non-critical entries outside of the quarterly closing process; and a fundamental realignment of task ownership. To enable the change, the company also instituted a training program, which is reusable as a refresher course or for new employees.

As a result, the company streamlined the close process with clear and transparent controls under the direction of the close champion; reduced the level of manual effort, improving the overall processing timeline and accuracy of data; and improved the functional skills of the organization, allowing resources to assist more proactively during the critical month-end period.

Financial controls

Low-cost performers are 20% less costly per key control than median.

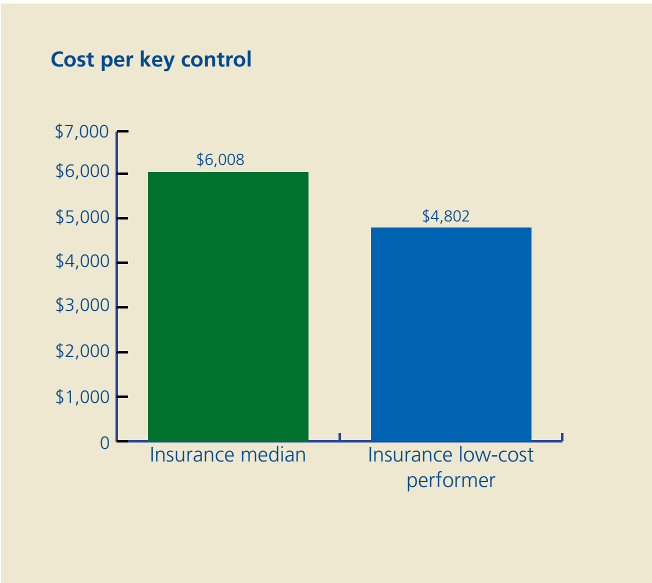

Figure 7.

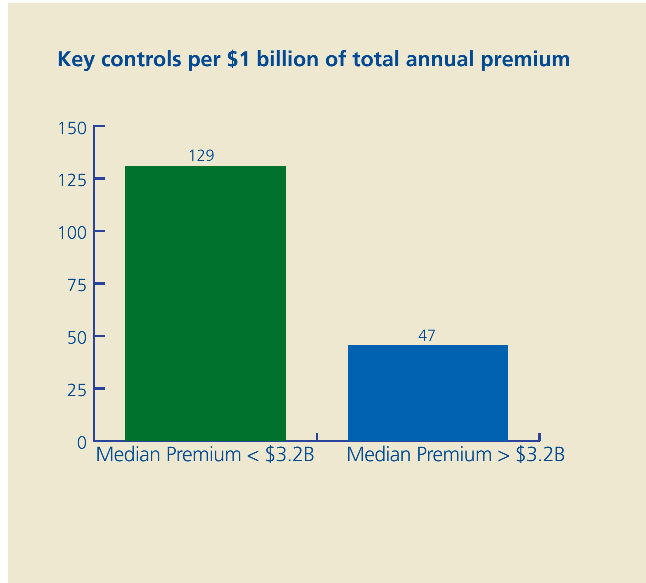

Figure 8.

> "Larger companies enjoy substantial economies of scale because they are able to leverage the people who focus on controls and, in many cases, process greater throughput with similar levels of controls."

With the introduction of the Sarbanes-Oxley Act in 2002, organizations made significant investments to document and improve controls. Leading-practice insurance companies have leveraged that information to institute process improvement programs both within finance and also upstream into the operational processes, where financial transactions originate.

Low-cost performers are 20% less costly per key control than the median (Figure 7). The gap between the median and low-cost performers is $0.6 million per $1 billion of annual premium.

Larger companies enjoy substantial economies of scale because they are able to leverage the people who focus on controls and, in many cases, process greater throughput with similar levels of controls. The lack of economies of scale that smaller companies face results in them having 174% more controls per total annual premium (Figure 8).

Financial controls can range from having employees review reconciliations and sign off on manual journal entries to creating automated system checks. By eliminating the human element and leveraging technology, the cost base goes down. That benefits smaller companies as well as larger organizations.

To improve their financial controls, leading organizations are applying a variety of strategies and tactics:

- **Technology** – Leading companies centralize control and risk information for easy analysis, reporting, and updates. This makes information available in real time and enables organizations to adapt to changing requirements. They also leverage upstream technology control options to reduce downstream manual processes.
- **Organization and Talent** – Because many controls begin upstream in operational processes, leading companies conduct training to ensure that staff in various functional areas – such as underwriting, claims, and reinsurance – understand appropriate regulatory and compliance developments.
- **Policy and Process** – Leading companies have also instituted an annual risk-assessment process to ensure continual monitoring of ongoing business finance risks and spend time evaluating only those controls that truly matter. In addition, they have created financial risk and governance programs that clearly define related controls and governance policies and processes.

Case study: Creating a documentation plan for financial control

A division of a multinational, multiline insurance company lacked formally documented controls and processes surrounding operational and financial reporting processes.

The organization suffered from: inadequate evidence and documentation of controls, specifically in areas requiring manual processes; inconsistent application of controls throughout the year, resulting in inaccurate or incomplete financial reporting; and inadequate change-management and data-feed controls.

To overcome these weaknesses, the organization documented the workflow and current control environment; created gap analyses highlighting key areas for control development and improvement; and implemented changes to improve current control environment, remediate gaps, and institute process improvements simultaneously.

As a result, the organization increased the degree of reliance on automated controls, right-sized the control framework using the documentation created to identify redundancies, and enabled a much smoother self-assessment and audit process due to improved documentation.

Performance management

Low-cost performers have 56% less staff than the insurance median; in addition, low-cost performers have shorter cycle times.

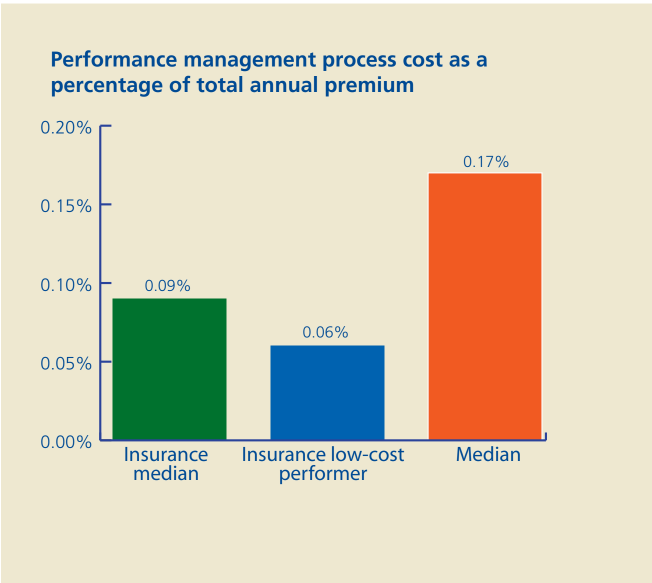

Figure 9.

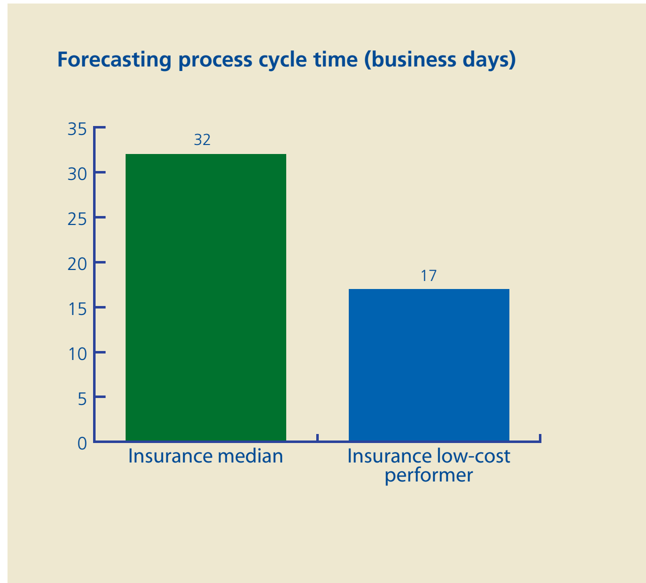

Figure 10.

"Insurers' costs, however, may be too low. The insurance industry may not be keeping pace with other industries in their level of investment in performance management. Some companies could be critically underinvested."

Effective management information and analytics are paramount to success in the insurance industry. So, too, is peak performance management, particularly in budgeting, reporting, and forecasting.

In benchmarking performance management, low-cost performers have 56% less staff than the insurance median (Figure 9). The gap between median and low-cost performers is $1.0 million per $1 billion of annual premium.

Insurers' costs, however, may be too low. The insurance industry may not be keeping pace with other industries in their level of investment in performance management. Some companies could be critically underinvested. Faster doesn't always mean better with performance management.

Low-cost performers also have shorter cycle times in performance management (Figure 10). Their planning cycle time is 15% less than the median and their forecast cycle time is 47% less than the median. But are the executives getting the information they need? Unlike the financial close, where there is effectively a predefined set of reporting requirements, the business intelligence space does not have such constraints. So, finance executives should really be challenging themselves to determine whether they and the business have what it needs to run effectively.

To improve performance, leading companies are employing a number of significant practices:

- **Technology** – They are using technology for successful planning, budgeting, and forecasting processes. The complex nature of revenue drivers, and often organizational structures, requires a toolset with distributed processing, robust reporting, and strong scenario planning.
- **Organization and Talent** – Leading companies are establishing a centralized performance management function distinct from other accounting and finance responsibilities. They are creating clear roles, responsibilities, and accountability throughout the organization for the controllable revenue and expense-planning activities. In addition, they are linking compensation and rewards to performance.
- **Policy and Process** – Identifying key drivers and limiting them to a manageable and interpretable set of business-related actions are key steps in performance management. Some insurers overanalyze their data instead of focusing on key factors that tie back to business actions. As a result, there is little ability to understand what forces are actually driving organizational performance.

Case study: A unified approach to global performance management

A major division of a large, multinational property and casualty insurance company was using disparate data management capture and reporting systems, which led to inconsistent processes across global regions. Methods for data transfer, reporting, and data roll-up to the corporate level were ineffective, and required a reporting tool to bring different business units across regions, onto one platform.

To improve performance management of this critical function, the division conducted a study to understand geographical process differences, and how best to integrate different processes into a standard global process. Next, the organization introduced a standard reporting and technology platform across all regions. The organization obtained cross-region buy-in to address differences while leveraging regional best practices at a global level.

After creating a streamlined, worldwide process, data transfer issues were overcome and allowed for regional reporting roll-up to the corporate level. In addition, regions were brought together under the global umbrella as a cohesive operating unit.

Looking forward

To stay competitive, insurance finance executives need to focus on a number of key issues that can affect the future of their organizations. These issues include:

- Balancing the various roles that finance plays within the insurance organization, from strategic partner to business steward.
- Optimizing the level of offshoring and outsourcing, and finding the right functions to move outside the organization.
- Evaluating the decision to reduce costs with the need to invest for the future, especially in a challenging and volatile economic environment.
- Preparing the organization to make the transition from Generally Accepted Accounting Principles to International Financial Reporting Standards.
- Enabling the business to make better decisions in a time when the quality of decision-making is more important than ever.
- Defining and managing the role of finance in corporate sustainability as the organization seeks to incorporate social and environmental considerations in the business plan.
- Developing a retention strategy that attracts and retains the best talent in the finance organization.

Benchmarking can help executives achieve these objectives by providing the organization with timely competitive insights to make informed investment decisions and changes. Through benchmarking, executives can:

- Identify and quantify potential improvement opportunities.
- Set reasonable, attainable performance goals and analyze trends from one year to the next.
- Establish targets that make sense and evaluate the accuracy of forecasts.
- Perform competitive analysis that leads to fast, meaningful improvement.

Moreover, a combination of industry-specific and cross-industry benchmarking can provide executives with a comprehensive view of leading practices that can invigorate their organizations and create a competitive edge.

With such information in hand, executives can make more informed decisions as they lead their companies forward during challenging business cycles.

Appendix

Methodology

This pilot study report is the result of collecting and analyzing data from 13 major domestic and international insurance companies. Companies included in the cross-industry median comparisons are of similar size and scope.

The study was conducted in 2008. Data points include process costs, headcount, cycle times, transaction volumes, and leading practice assessments.

In calculating percentages, the denominator used for the insurance industry is total annual premium earned; for non-insurance companies that constitute the cross-industry median, the denominator is annual revenues.

Profile of participants

The companies that participated in this study represent a cross-section of the insurance industry:

- Annual premium: $798 million to $21.1 billion, with a median of $3.2 billion.
- Gross revenues: $1.7 billion to $25.9 billion, with a median of $5.2 billion.
- Three-year compounded annual growth rate: -8% to 29%, with a median of 5%.
- Operating expenses: $5.6 million to $656 million, with a median of $173 million.
- Assets under management: $2.4 billion to $426.8 billion, with a median of $19.4 billion.
- Number of active policyholders: 353,000 to 15 million, with a median of 2.4 million.

Definitions of process functions

Following are the process functions represented by each of the finance functions in this study:

Transaction processing	General accounting and external reporting	Financial controls	Tax and treasury	Performance management
• Accounts payable • Accounts receivable • Actuarial accounting* • Billing • Credit • Collections • Deferred acquisition cost accounting* • Fixed assets accounting • Payroll • Premium tax accounting* • Reinsurance accounting* • Revenue accounting • Travel and entertainment	• External reporting • General accounting • Statistical reporting*	• Internal audit • Risk management • Sarbanes-Oxley compliance	• Tax-income • Tax-property • Tax-sales and use • Treasury	• Budgeting-capital • Budgeting-expense and revenue • Business financial analysis • Financial management reporting • Forecasting

* Insurance industry-specific process

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