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Unlocking the potential of Finance for insurers

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Executive summary

The role of the Finance function has become increasingly important as insurance companies seek to respond to uncertain and volatile business conditions, as well as comply with new regulatory requirements. The strategies that many companies are pursuing include organic growth through improved underwriting and new products, strategic acquisitions, and improved capital and investment management, including share repurchases and alternative investment strategies. Given slow growth and soft pricing for many products, improving the efficiency and profitability of operations are also high priorities.

Finance has an important role to play as companies develop these strategies. Finance should consider first serving as a steward by accurately reporting on the company's financial and operational information, and by helping meet regulatory requirements. The efficiency of Finance processes is also receiving greater scrutiny as companies search for cost savings, especially in functional areas that do not generate revenues.

To take the function to the next level, Finance should then expand its focus to include becoming an invaluable business partner. Finance has the opportunity to drive additional value by using analytics to provide actionable insights that help inform business strategy, as well as by providing analyses that improve the predictability of business performance. By taking on the role of business partner, Finance can set the example for improved collaboration and how to "make the value pie" bigger for the organization.

Insurance companies should establish priorities among the different roles that Finance can play and assess which of its capabilities should be enhanced. Does Finance have a clear understanding of its charter and the expectations of its clients within the company? Does Finance have a clear governance and organizational structure? Is it able to attract and retain the talent it needs? Does it have standardized, integrated, and efficient business processes? Is the technology infrastructure available to manage financial controls and reporting and to provide analytics that support business decisions?

Based on this process of self-reflection, an insurance company can prioritize its areas for improvement and develop an action plan for Finance transformation. Companies that have shortcomings in their financial reporting and controls should generally focus on enhancing their capabilities in these areas, which form the foundational elements of a strong Finance function. But these are only table stakes.

Companies that have effective financial reporting and controls, but are seeking to enhance the ability of Finance to contribute to the company's business strategy, should focus on capabilities such as having analytical and strategic skills among the workforce, as well as the technology infrastructure needed to employ analytics to provide decision support and identify opportunities.

Designing and implementing Finance transformation may be especially difficult for insurers due to fragmented legacy systems, regulatory reporting and disclosure requirements, and complex financial accounting. In today's uncertain business environment, however, Finance has the opportunity to play a more important role, not only in financial reporting, but also through improved analytical insights, decision support, and capital management. To realize its potential to add value, an insurance company should consider moving beyond incremental improvements to develop a strategic vision for how the Finance function can become a business partner and then undertake a transformation to make that vision a reality.

Increasing role of Finance

An uncertain macroeconomic environment, coupled with weaker business conditions in the insurance industry, has raised the profile of the chief financial officer (CFO) and the Finance organization in many insurance companies. U.S. economic growth was modest in 2012, while unemployment remained around 8 percent. Growth is flat across the Euro area as a whole, as policymakers continue to struggle to manage the Euro crisis.[1] Growth in emerging market economies also slowed in 2012. Further, interest rates are at historically low levels and are expected to remain low in the United States at least through 2014.

Regulatory developments have created additional uncertainty and burdens. Although the impacts are not yet clear, new regulations incorporated in the Dodd-Frank Act, Solvency II, and the Solvency Modernization Initiative launched by the National Association of Insurance Commissioners are already affecting insurers.

For example, the adoption of Solvency II in Europe has placed greater demands on insurers to meet the requirements for data, for reporting, and for assessing risks, and these new requirements are likely to impact how those European insurers do business in the United States. These developments present an opportunity to drive improved decision making and capital management by integrating an organization's risk management and financial information.

The nature of the business is changing for many types of insurance. The trend toward direct distribution continues, and changing demographics are leading to new customer requirements. Many insurers are responding to these developments by exploring opportunities for profitable organic growth through disciplined underwriting and product differentiation.

In life insurance, many companies are seeking to introduce new products to appeal to high-growth customer segments. In commercial property and casualty, many insurers may be looking for greater risk diversification while battling pricing challenges. Certain companies also remain on the lookout for strategic acquisitions that may offer economies of scale as well as provide opportunities to penetrate new lines of business or geographic markets. Weaker business conditions have placed a premium on reducing operating costs through operational efficiencies.

Low interest rates have led some companies to look to invest their reserves in alternative assets to boost returns. Many companies also find themselves with excess capital, which serves to depress returns on equity. As a result, more companies may seek to reduce their level of excess capital through share repurchases or redeploy capital through mergers and acquisitions.

In today's turbulent and more highly-regulated business environment, the Finance function has become more central to the fortunes of many insurers. In addition to its traditional responsibility of "preserving value" through reporting, controls, and risk management, Finance is increasingly expected to "create value" by developing and executing business strategy in such areas as profitability analytics, mergers and acquisitions, capital management, and integrated performance management.

Insurance companies have often lagged in using sophisticated financial analysis to inform business decisions. In part, this is often due to data and technology challenges from aging and fragmented systems but also simply due to a historical lack of focus on the challenge. CFOs have the opportunity to create analytics around customer profitability to inform distribution strategy and product design. The quality of financial reporting can also be enhanced to facilitate decisions on matters related to risk, treasury, reinsurance, and operations.

At the same time, companies are likely to place the Finance function under close scrutiny as they search for cost savings. While insurance companies have centralized processes and employed shared services models, many insurers can further lower costs and improve quality by migrating additional functions to low-cost shared services centers or to offshore captive operations.

[1] World Economic Outlook: Growth Resuming, Dangers Remain, International Monetary Fund, April 2012, http://www.imf.org/external/pubs/ft/weo/2012/01/pdf/text.pdf

Setting a strategic vision

To seize these opportunities, point solutions or "bandage" approaches may not be enough. Many insurance companies may likely need to change their Finance organizations to meet the demands of today's marketplace.

Insurers should begin by clarifying the priorities they assign to each of the four principal roles Finance can play (Exhibit 1):

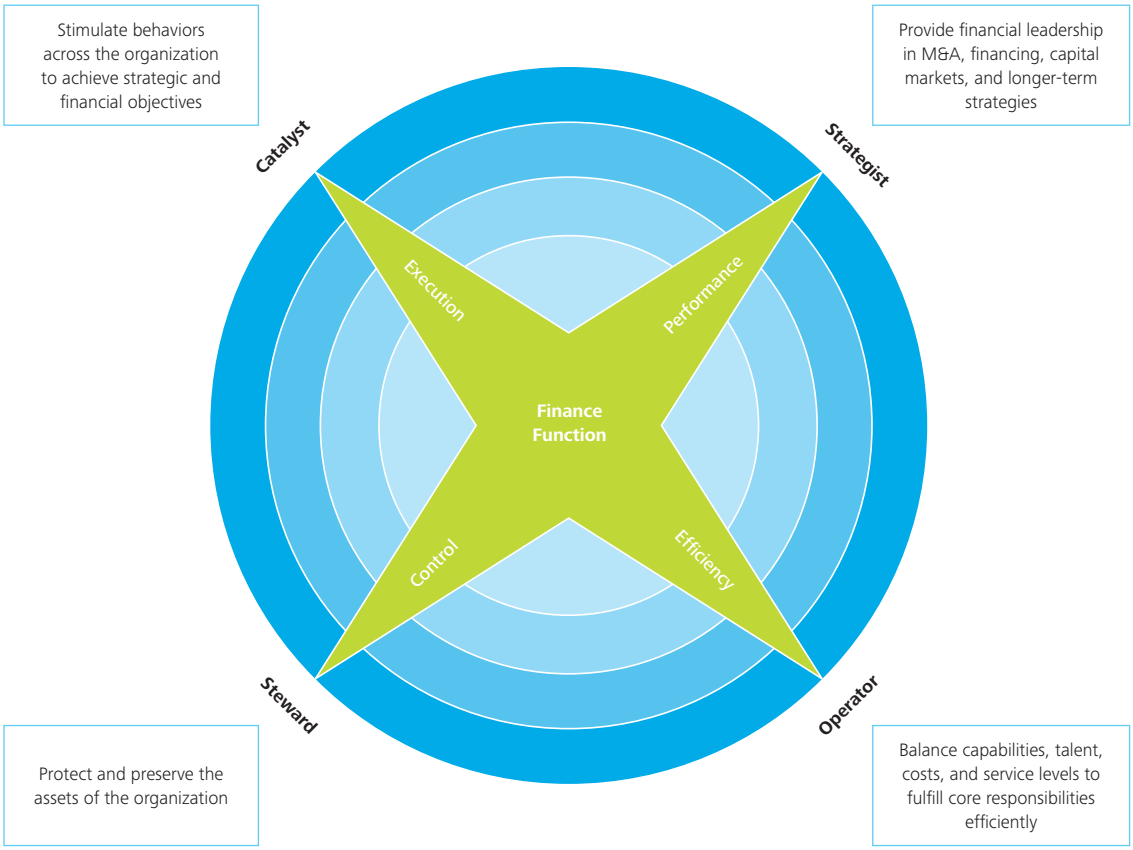
- **Steward**: Accurately report on the company's financial position and operations.
- **Operator**: Provide high-quality finance services at an effective cost, while maintaining the flexibility to respond to the changing needs of the business.
- **Strategist**: Help set the strategic direction of the company by providing decision support through actionable insights and by conducting forward-looking analyses that improve the predictability of business performance.
- **Catalyst**: Help provide the business with valuable insight and analysis to support decision-making, creating a risk-intelligent culture.

The importance of each of these roles varies across companies. In a company seeking to increase profits through improved service and greater efficiency, while maintaining its current portfolio and geographic footprint, the roles of Finance as a Steward and Operator will likely have greater prominence. On the other hand, in a company with an aggressive growth strategy that is introducing new products, entering geographic markets, and making acquisitions, Finance should have a greater opportunity to add value by serving as a Strategist and Catalyst.

These roles build on one another. If Finance is not an effective Steward, then it should first confirm it has business processes and a technology infrastructure in place that provide accurate financial reporting without control weaknesses. If this foundation is already in place, then it can consider moving to improve its processes by driving operational efficiencies through automation, streamlining reporting processes, and improving the depth of analysis.

Insurers that have improved data quality and transparency by building a Finance IT architecture that relies on a single source of data for reporting across the organization can move to the final level: becoming a business partner that serves as a trusted advisor to the business units through analytics around profitability, capital management, and risk management. The opportunity for Finance to collaborate with businesses in this way is often greatest at significant moments such as major investment decisions, business restructurings, and strategic cost initiatives.

Exhibit 1: Establishing the priorities for Finance
The four faces of the Finance function



Developing a roadmap for change

After clarifying the importance of each of the roles Finance plays, a company should conduct a gap analysis to assess the current capabilities of Finance and where these capabilities may need to be enhanced. Does Finance have a clear understanding of its charter, the expectations of its clients within the company, and its current gaps in capability to meet them? Is there a **clear governance and organizational structure** that helps align efforts of Finance with those of the business units to achieve sustainable improvements?

Is Finance able to attract, retain, and develop a **talented workforce** with the right skills in the right roles, supported by effective performance management systems? Are there standardized, integrated, and efficient **business processes** that assist Finance to add value and do so cost-effectively? Is the **technology infrastructure** available to support financial reporting and controls, employ advanced analytics, and generate efficiencies?

Insurance companies have different characteristics that can make Finance transformation more difficult. The front office—claims and underwriting—is often composed of multiple fragmented systems that may present a multitude of data challenges. Insurers are regulated, which creates additional challenges around multiple bases of reporting as well as deep and broad disclosures and inquiries.

Finally, financial accounting for insurers is far from straightforward. For example, much of the right side (liabilities) of the balance sheet is actuarially validated and derived requiring specific and complex financial modeling. These and other complexities can make Finance transformation especially challenging for insurers.

The goal of the gap analysis is to analyze the function objectively in order to change the strategic vision for Finance into an actionable roadmap that details the investments and actions needed to make the vision a reality as well as the benefits to be achieved.

The priorities assigned to the various roles that Finance plays should have a major impact on developing an action plan. If Finance already does a strong job as a Steward and Operator, but has set a goal of becoming a more effective Strategist, then initiatives to improve its capabilities in this area will be more important. Finance would need to assess whether it had a workforce with the required analytical and business skills and a technology infrastructure that could support business analytics.

The analysis will typically result in more areas for improvement than can reasonably be addressed simultaneously. In choosing among them, companies should consider both the potential impact each improvement may likely have and also the effort required in financial resources and executive attention to drive improvement.

At the same time, a company should consider articulating a clear picture of how the planned changes can impact and assist the target vision. Companies will often begin by harvesting "low-hanging fruit," i.e., initiatives that require only small amounts of effort but promise a high impact by improving multiple processes or making a major impact on business objectives.

However, Finance transformation should not become stuck in a short-term mindset—focusing only on initiatives that can be accomplished quickly with few resources. Although this approach can yield improvements, it will likely not generate the more substantial benefits that can be achieved through taking a longer-term approach and tackling more challenging objectives.

Companies should also consider areas that offer a high impact but also require a substantial effort such as requiring the major involvement of business stakeholders, deep financial or human resources, or significant changes to business processes or the technology infrastructure. These high-impact projects should be seen as longer-term investments in enhancing the Finance function, but are initiatives that will likely require much of the rest of the company to support their implementation.

Failing to test such large-scale changes could decrease future performance capability over the long term, while increasing the complexity and effort required to implement improvements down the road.

Potential benefits of Finance transformation

The enterprise-wide benefits of a Finance transformation project can be substantial. These benefits depend on the specific objectives established but typically fall into the following broad categories.

Enhanced controls

Projects that address controls may help ensure there is a "single version of the truth" for financial information, reduce the risks related to financial reporting and auditing by decreasing the potential for financial misstatements, and improve risk awareness and capital management. They may also help a company meet the new regulatory requirements being introduced.

One major insurance company faced challenges in its controls and processes around its reconciliation procedures. Its transformation project allowed the company to reconcile significant open intercompany balances and also upgrade its intercompany accounting procedures and controls. In addition, the company implemented a methodology for quantifying P&L exposure for unreconciled historical account balances, which allowed it to track these exposure estimates over time. Enhanced reconciliation procedures improved documentation and the mechanisms to track inter-company balances. Effort during the close cycle was reduced and audit efficiency gained.

Improved efficiency

Projects that address business processes may increase efficiency and reduce operating costs as a percentage of revenues by standardizing and automating transactional processes, integrating financial information systems, and engaging in ongoing process improvement. These streamlined processes can also provide Finance with the ability to close the books and provide reporting in a timelier manner.

A global insurance company struggled with inefficient finance processes due to decentralized operations that resulted in multiple accounting processes, systems, and tools. The result was significant manual and exception-based processing; disparate, uncoordinated initiatives to address operating inefficiencies; and the lack of an overall roadmap for financial processes and related financial technology. By improving sub-ledger capabilities, many of the manual processes previously required to bridge to the legacy sub-ledger and general ledger were either eliminated or substantially improved in terms of control and efficiency.

Increased effectiveness

Transformation has the potential to make Finance a more effective Strategist by increasing its transparency into decision-support information and its ability to use advanced analytics to provide actionable insights on M&A, pricing, products, market entry, and other business issues. Similarly, it may lead to more accurate financial forecasts that improve the predictability of business performance.

One of the world's largest insurance companies, serving millions of customers in various geographies, faced fragmented data and reporting in the Finance function that prevented it from providing the insights needed to inform strategic decisions. The company created a regional Finance function that standardized financial data and reporting and gained the capability to analyze profitability by product, channel, and customer segment. These improvements in data quality and analytical capabilities allowed Finance to provide actionable insights that support decision making.

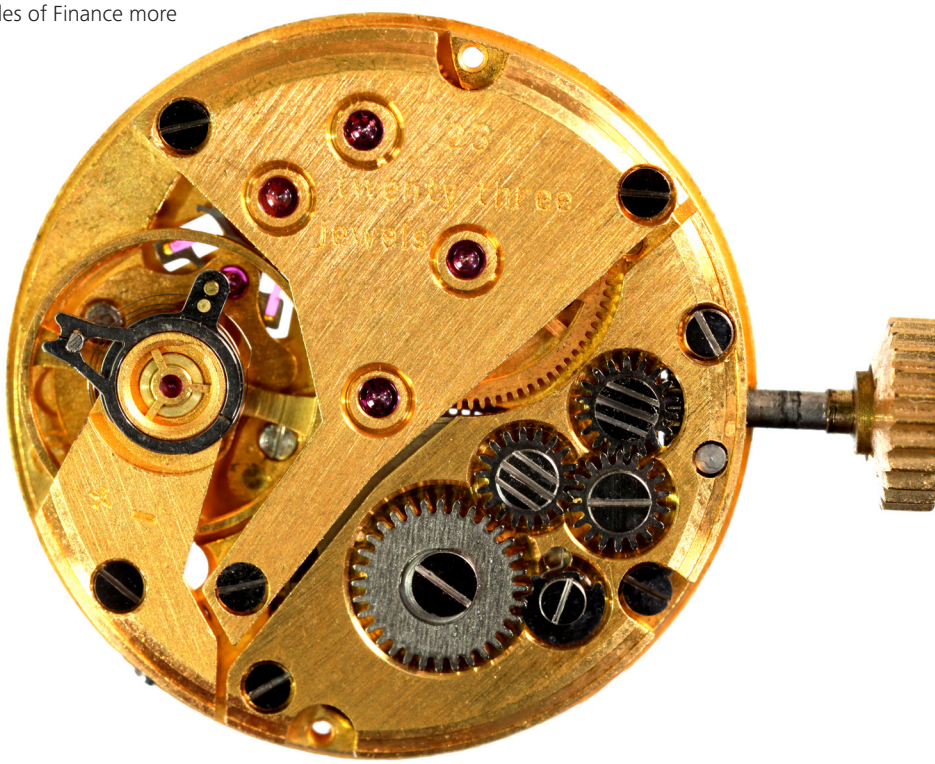
Another major insurance company focused on its Financial Planning and Analysis function to better define its most important performance measures and standardize their definitions. By developing a relationship with the front office as a business partner, Finance was able to provide more refined and relevant information on a more frequent and accelerated basis.

Improved talent management

Projects that address a finance talent strategy may also improve Finance's ability to attract and retain talent with the appropriate skills, develop professionals and provide them with leadership opportunities, as well as enhance performance management and compensation programs. As its roles evolve, Finance might require a more diverse range of skills.

A national multi-line insurer identified the need to improve the skills of its Finance professionals including leadership skills, providing business and strategic advice, and analytical competencies. The company developed a competency model specific to Finance and established an integrated talent management program for the function. Among the initiatives introduced were a detailed training program, a competency and talent assessment, and initiatives in recruiting, performance management, and succession management.

Focusing on talent helps in the execution of many improvement initiatives but also can allow the function to better address the multiple roles of Finance more effectively.



Conclusion

Finance has an important role to play as many insurers seek to achieve profitable organic growth, make strategic acquisitions, achieve operating efficiencies, and improve capital management. Insurers that engage in Finance transformation have the potential to capture significant benefits in these areas. Depending on a company's objectives, benefits may include enhanced controls, improved operational efficiency, improved talent management, and a greater capability to contribute to business strategy by using analytics to develop actionable insights.

Achieving the potential of Finance to add value often requires companies to take a holistic view—considering which capabilities should be targeted for improvement based on the importance of the various roles that Finance plays in the organization. Finance, IT, and the individual business units should be committed to the effort and work cooperatively, typically supported by full-time resources.

Transformation projects should have bold goals but should also establish a limited number of high-impact objectives. While these principles may increase the likelihood of success, in many ways, the first step is the most important one: Beginning with a clear strategic vision of the different ways that Finance can help the company achieve its business objectives.

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