The impact of Solvency II on data management in insurance

Insurance

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In recent years, the Luxembourg insurance industry has been under the ever-growing pressure of regulations such as Solvency II. In a nutshell, Solvency II impacts the way insurance companies manage their risks and has consequences across the entire company, e.g. capital, governance, processes and systems.

Consequently, data is an important and wide-ranging topic in Solvency II. Furthermore, data is directly targeted by Solvency II, as it is required to be accurate, complete and appropriate—not to mention traceable. Unarguably, this is easier said than done: especially as the regulators will most likely impose strict penalties. For instance, insufficient data quality will result in an insurer being forced to build and maintain additional capital in order to provide a cushion in the event of errors in the calculation of capital requirements. As a result, the prerequisites for meeting the Solvency II requirements are data governance and data control.

Most insurers are facing the same challenges. Actuaries and risk managers often use a mix of IT extracts from heterogeneous operational systems and various business-managed end-user computing files, causing reconciliation challenges, knotty problems and many other issues. Many manual adjustments are performed, often in a decentralised form, causing important losses of traceability. Data quality checks—when performed—are usually informal and data is not stored in consistent sets, making the reuse of a given input set extremely difficult. Furthermore, insurance companies have to contend with increasingly heterogeneous data sources, both internal and external, and given both data pushing and pulling.

Nevertheless, Solvency II is far from being the only driver for data management, and neither is it the oldest one. Top-line growth (revenue generation) has always been a concern and a challenge for insurers. Although these days the insurance market appears to be mature, providing limited opportunities for growth at first sight, experience shows that insurance firms still have great potential for improving customer value. To effectively and efficiently benefit from this potential, the starting point should be to identify which customers create and destroy value, and to what extent they do so. This requires excellent insight into key customer information, such as profitability, churn and loyalty drivers. The second step, i.e. customer segmentation, should be performed on quantitative characteristics, to differentiate customers from each other and group them into business-meaningful clusters. These characteristics include—but are not limited to—product ownership, sales channel preferences, socio-demographics and transactional data. If required, the third step for improving the customer value curve should involve the concept of selective retention, i.e. retaining valuable

customers, while letting go of non-profitable ones. The main challenge in this process is that it requires the cross-referencing of different data sources, e.g. customer relationships, and operational and financial databases.

Along with top-line growth, bottom-line growth (cost reduction) is another essential driver for data management. Bottom-line growth, once the top-line is fixed, relies mostly on the reduction of operational costs. And experience shows that the greatest operational cost linked to data management lies in the duplication of extracted data. In many companies, the IT department is bombarded with numerous and repeated requests for data extracts from all departments. Hence, multiple duplicates are created and spread across the company causing consequent losses of ownership. For that matter, increasing automation in data management is key to reducing errors and correction costs, spotting inefficient cost centres and rationalising the interfacing with data repositories.

Finally, there is one other data management concept that is ideal for meeting the requirements of Solvency II: data centralisation. Building up an Enterprise Data Warehouse (EDWH) in an insurance company is the best way to gather all corporate data at a single point and with a single version of the truth in a unique and standardised format, and to make it available for all departments.

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This is where Solvency II can play the essential role of an enabler. Implementing Solvency II is unarguably a heavy investment, and so everyone's goal should be to reach an acceptable level of compliance at the most reasonable cost. However, this should not be quite the end of the story. Indeed, considering Solvency II in terms of a constraining regulation only would be a huge missed opportunity. We believe Solvency II is an extremely powerful springboard for implementing an EDWH and revising data governance, based on a two-step roadmap:

1) Identify your dashboarding and reporting needs and
2) Identify among these needs quick wins with Solvency II data requirements

The whole idea is very simple: Solvency II—given the heavy and mandatory investment it requires—must be used as a lever for implementing data management mechanisms and building an EDWH. Through revenue generation and cost reduction, these will make a major contribution to business growth by enabling you to implement and benefit from the latest data exploitation techniques, such as business intelligence and analytics.