

# Turning the compliance challenge into a business advantage



An Economist Intelligence Unit report sponsored by SAP

## Preface

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## Transparency as an advantage

**F**rom the Health Insurance Portability and Accountability Act (HIPAA) in the US to the Solvency II framework in the EU, new rules have spawned an army of consultants, vendors and solutions to address the “compliance” problem. But the current level of anxiety over compliance may be short-sighted. In fact, the need to achieve the higher levels of transparency required by regulators may lead to business advantage.

Complexity and transparency are adversaries—and insurance is among the most complex industries in the world. Given the siloed, line-of-business oriented structure of insurance operations and the M&A-driven complexity of systems, insurance companies do well to achieve translucence on an enterprise level, let alone transparency. But the

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industry’s opacity is also the reason intensified compliance demands can be seen as an opportunity: they provide the impetus to break through the territorial management of business units, with the accompanying reliance on multiple reporting technologies, dependence on manual reconciliation of stacks of spreadsheets and other disparate and antiquated approaches.

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## The case of Securian Financial

**S**arbanes-Oxley is one of three drivers (along with the need for enterprise risk management and the move toward principle-based reserving), that is causing Minnesota-based Securian Financial to achieve greater transparency and precision in its financials, according to Robert Reynolds, director of life product management for the firm’s Minnesota Life business unit. The ability to view financial controls clearly and affirm that the right controls are in place is a significant opportunity for the insurance industry, Mr Reynolds believes. While the immediate cause may be the

desire for compliance, “you are also going to have a much better way of identifying exactly what is contributing to your financials,” he argues. “The news may be good or bad, but you will know exactly where the accountability is—and that transparency will be a business advantage.”

According to Mr Reynolds, technology is the enabler of both transparency and efficiency. He says that Securian is finding many opportunities to automate, using vendor software and outsourcing, because technology-based tools are more available than ever before. “Those solutions cut down the



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absolute number of controls by eliminating manual steps in the creation of financials, and that serves both accuracy and efficiency,” he says. “That gives you more control of what shapes your company’s reputation, and that in turn can only increase consumer confidence.”

Without that kind of control, the odds of a misstep increase. Obviously insurance companies have functioned over the years, even turning underwriting profits. But as with the proverbial business of sausage-making, while the result may be acceptable, the process may be painful to witness.

Even deep within functional silos, such as in claims departments, the slow and manually driven recording of information and the reliance on batch processing limits the ability of companies to respond to ongoing changes. “If you’re receiving paper reports 15 to 45 days after the close of the quarter, you don’t have the ability to manage in any fashion other than reaction,” observes Rob Schwartz, industry principal, SAP. “By the time you are aware of the problem, the time to take corrective action may have passed and the damage is done.”

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## Compliance and business challenges converge

**T**he culprit is the decentralised nature of compliance-related processes, exacerbated by the lack of both systems integration and interoperability between functional systems such as underwriting and claims. According to Mr Schwartz, insurers should recognise that compliance and business

Such capabilities are useful for existing, emerging and ad hoc regulatory demands. For example, during the response to Hurricane Katrina, insurance carriers handling claims were required by a committee of state governors to report where they stood with respect to reserves. Many were fined. “They had people manually

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adjusting claims with paper and pencil and simply couldn’t meet the requirement,” Mr Schwartz recalls.

challenges are converging and the technology to meet them is available. Standardising and consolidating core functions can make it easier to provide required information to regulators and rating agencies as well as to monitor the drivers of that information. Carriers can also enjoy a nearer-to-real-time view of transactional information – not to mention the ease of incorporating this information into the financials.

He also tells the story of one of the few that escaped sanctions. “The adjusters were in the field, they were looking at losses and adjusting the reserves, and the reserves were rolling up into their financials,” Mr Schwartz says. “This is one example of how automation and transparency between systems lends itself to improvements within the business of insurance.” These improvements include improved efficiency and the ability to manage to both short-term business realities and long-term strategy goals.



## Where pricing and risk management meet

**A**t Securian Financial, technology and process improvements are driving fundamental change in the way the firm does business. Anticipating an industry-wide change, the firm has been navigating a long-term shift from statutory accounting and reserving (which employs uniform risk assumptions for all companies) through GAAP accounting and on to an economic accounting approach that **utilises** company-specific assumptions to generate more precise pricing and more accurate and timely financials.

Such a shift is necessary, according to Securian's Mr Reynolds, as the insurers sell more equity sensitive products, such as variable annuities, in "a convergence of the capital markets and the insurance markets." Traditional statutory accounting, with its extremely conservative assumptions, blurred the actual value of products and portfolios. Principle-based accounting achieves a far more accurate picture by building assumptions using a company's own experience of mortality and other variables. It enables the companies who use it to say, "this is what we would be willing to pay someone to take over our obligations or, on the asset side, this is what somebody would have to pay us for these assets we possess," Mr Reynolds explains.

However, instead of using ready-made statutory formulas with predictable if blurry outcomes, principle-based accounting requires creating proprietary assumptions and stochastic modeling of risk scenarios. "In the past we would run through basically one scenario; now we're running through thousands of scenarios to stochastically see if we're victorious at a high enough percentage so that the decisions we are making are defensible," Mr Reynolds says.

To provide uniformity across the company, Securian has implemented an enterprise-wide actuarial

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modeling system. The system will help Securian get ready to comply with the industry's eventual adoption of principle-based reserving. In the meantime, it will help the firm to price its products more **accurately deliver** timely and realistic picture of Securian's financial state. "We're going to understand much more clearly what our risk appetite is and whether our product portfolio is matching up with that," Mr Reynolds says. "That will also help us understand how much capital we should be holding to support the risk we're assuming."

#### **Now it's your turn**

Relying on transparency is an attractive regulatory strategy: it requires low resources on the part of regulators and exposes timely and accurate information to stakeholders, analysts and the public. But it's hard to be transparent when the underlying business is needlessly complex. To reap both the business and compliance advantages of greater transparency:

- **Standardise** and **centralise** enterprise functions to facilitate the provision of required information to regulators, rating agencies and auditors.
- Remember that the transparency and currency of information achieved will offset costs by enabling vastly improved strategic insight.

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