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white paper | insurance accounting for brokers

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SunSystems
Insurance

Insurance Accounting for brokers.

Insurance Accounting (IA) demands a different approach

General description of the broking process.

An insurance broker arranges insurance for a client with insurers (commonly called underwriters or carriers). The broker is responsible for collecting the premium from the client, apportioning it between the underwriters and any third parties involved (who will receive commission for services rendered) and paying the recipients. The broker receives commission (brokerage) for arranging the insurance.

When the client has a claim, the reverse process takes place. The claim is apportioned across the underwriters, payments collected from them and as money is received it is passed on to the client. However, the payment process should include controls so that claim payments are only made to the client when funds have been received from the underwriters. Commissions should be controlled in a similar way so that payments are not made to brokers until premium payments have been received from the client.

Requirements for an IA ledger

Insurance Accounting (IA) has to be supported by an IA Ledger to record the financial impact of broking transactions. The key functional requirements for an IA Ledger include:

Support for the multi-faceted nature of broking transactions:

Broking transactions are complex due to the number of parties involved in a single transaction, and an IA Ledger must accommodate this complexity. For premiums, an IA Ledger must debit the client, credit the underwriting market, credit any third parties and credit brokerage. For claims, the IA Ledger must debit the underwriting market and credit the client. Other transactions will debit and credit any combination of client, underwriters, third parties and brokers. Cash is received or paid out for any participant of the transaction apart from the broker whose share goes into the nominal ledger.

Purpose of this document.

This document gives an overview of the SunSystems IA Ledger solution. This is being developed in partnership with one of our clients, a major international insurance brokerage and risk management company. This White Paper is intended to give potential customers an understanding of the scope of the SunSystems IA Ledger and its benefits compared to alternative solutions.

Why should you consider an IA Ledger?

Most insurance companies have relied on home-grown or legacy systems to perform the functions of Insurance Accounting. In many cases, these systems are old, difficult to maintain (due to extensive customization) and often augmented by manual processes. With the impending regulation by the FSA, this will no longer be acceptable. Insurance companies should review their back-office finance and business management solutions to ensure they will meet FSA requirements. The FSA will monitor subjects ranging from financial crime through to services, product and advice provided to customers. A commercially developed IA solution with powerful financial functionality delivering comprehensive management information, all from a single integrated solution delivered by a reputable supplier of business management software will be an important foundation for insurance companies that wish to succeed in the new regulatory environment.

"Pay-as-paid" functionality:

An IA Ledger must provide controls that prevent payments being made to the client or underwriter before payment is received from the underwriter or client. This supports better management of funding in complex broking transactions.

Integrated view of activities:

The IA Ledger must provide summaries of activity by Client, Underwriter and Third Party. It must also support the concept of Principal to Principal accounting to show which carriers/underwriters carry a risk and how the risk is apportioned.

Complex multi-currency processing:

The global nature of broking activities means that an IA Ledger must support complex multi-currency processing. In addition to handling different transaction and reporting currencies, an IA Ledger must support:

- Different billing currencies for premiums split across Underwriters.
- Nominated "banking" currencies (i.e. bank accounts are maintained in these currencies) for receipt of premiums and payment of claims.
- Alternate settlement currencies so that Underwriters may elect to receive premiums and pay claims in currencies other than the banking currencies.

An IA Ledger should also provide reporting and analysis to meet the needs of all parties involved in broking transactions and regulatory requirements, which are soon to be the responsibility of the FSA.

IA ledgers and traditional accounting systems

The similarities

There are a number of similarities between an IA Ledger and "traditional" ledger-based accounting systems. All ledgers are based on the principle of debiting someone in order to receive money from them, or crediting someone to pay money to them. Cash is then received/raised to settle the debt/credit. Cash is credited/debited to bank accounts and its processing is similar whatever the business.

In the insurance broking environment, the client is the broker's customer and the client ledger is conceptually similar to a receivables or sales ledger. Similarly, the broker purchases cover from the underwriters on behalf of the client. The underwriters are acting as "suppliers" and an underwriter ledger is similar to a payables or purchase ledger. Third parties provide services in return for fees. Thus third party ledgers are also

An unbeatable combination of low risk, cost of ownership and insurance specific functionality is just one of the reasons why SunSystems is the premier choice for insurance accounting solutions.

similar to payables or purchase ledgers. Inward commission will be on the receivables or sales ledger with the offset on the nominal.

Statements of account are produced from an IA Ledger to show the status of the indebtedness between the parties in much the same way as supplier or customer statements in accounting systems. Aged debtor reports are used to control the debt position. Trial balances are run as a standard report on most ledgers to support auditing requirements.

The differences – and why these matter

Many vendors of accounting systems have made the mistake of assuming their solution can be made to "fit" the requirements of insurance brokers because of the similarities between IA Ledgers and traditional accounting systems. However, there are some key differences that mean the receivables/payables (sales/purchase) ledger functionality in traditional accounting systems is not adequate to meet the needs of insurance broking.

The major difference relates to the role the broker plays as an intermediary. The IA Ledger receives details of the apportioned transaction (premium or claim). Money received on one side (premiums from the clients, claim payments from the underwriters) needs to be passed on to the other side of the transaction. The premium or claim transaction therefore needs to be registered within the ledger and the link between the client and underwriter maintained to enable receipt of money on one side to trigger payment on the other. This is difficult in most accounting systems where payables and receivables ledgers are separate entities in which transaction linking is not permitted, as accounting principles do not generally allow this practice. The boundaries between payables and receivables ledgers to support insurance broking can only be broken down through significant customisation of the delivered accounting system.

Even if the boundaries between ledgers can be broken down, this may still not accommodate the nuances of the broking relationship. Traditional accounting systems are designed to deal with debtors (accounts receivable) and creditors (accounts payable). While it is reasonable to think of the client as the broker's customer for the processing of premiums, this relationship is reversed when claims are paid to the client. The same is true of underwriters, who are creditors when they provide cover but debtors when claims are paid. Many traditional accounting will be unable to cater for this complexity, enforcing a debtor- or creditor-centric view of activities rather than providing a holistic view from the broker, client or underwriter's perspective.

Finally, there is still significant business process functionality required to provide a full solution to the needs of insurance brokers. As an example, the complexities of currency processing in global broking environments mean the system must be capable of managing five currencies for each transaction. Very few accounting systems deliver this capability as standard.

Potential purchasers of IA functionality must understand the implications of these differences. Vendors of "generic" financial or ERP systems are likely to approach them claiming they have solutions for the insurance industry because they have a number of insurance users. However, these will use the finance systems as "back office" General Ledger systems. They will most likely not support the complexities of broking activities and the customization required to deliver these will significantly increase the implementation costs, making the system very difficult to support, maintain and upgrade.

The SunSystems IA ledger solution

SunSystems IA ledger overview

SunSystems has developed a complete IA Ledger solution based on its industry-leading accounting and financial management software, SunSystems 5. This has been achieved because the underlying architecture of SunSystems 5 differs from the majority of accounting systems, and this architecture supports the requirements of an IA Ledger. SunSystems 5 is a single ledger system, which means that all ledgers (general ledger, sales ledger, purchase ledger and even user-defined ledgers) exist as a single entity with real time update across all ledgers. This means postings to customer or supplier accounts are reflected immediately in the general ledger. This architecture therefore supports the multi-faceted nature of insurance broking transactions, where nominal ledger and client, underwriter and third party accounts must be updated immediately, with a seamless view of transactions across all ledgers. Traditionally-architected accounting systems cannot support this functionality without significant customization.

However, the SunSystems IA Ledger is more than a rebadged accounting system. Systems Union have developed additional functionality to support the needs of the insurance broking industry so that the SunSystems IA Ledger is a comprehensive financial management solution for insurance brokers. This includes full Pay-as-Paid functionality, Principal To Principal accounting, the capability to process up to five transaction currencies and summarized views of activity by Client, Underwriter and Third Party. Please see Section 5 for an overview of SunSystems IA Ledger functionality.

The SunSystems IA Ledger is being developed as part of the core SunSystems product set. This means that it is part of a single code line and leverages the underlying strengths of the SunSystems 5 architecture.

Benefits of the SunSystems solution

The SunSystems solution offers major benefits to insurance brokers over alternative offerings. Unlike other systems from accounting and financial management vendors, the SunSystems IA Ledger supports the multi-faceted nature of broking transactions with real time update

SunSystems is used by over 400 insurance companies.

across multiple ledgers. It also provides the functionality that is needed to support financial management processes in insurance brokerage.

IA Ledger solutions are also available from specialist software vendors focused on the insurance industry. These solutions offer the specialist functionality required for insurance broking, but tend to be weak in the complex areas of financial management such as multi-currency and management reporting. Only SunSystems can offer the unique combination of IA Ledger functionality and industry-leading accounting and financial management functionality to provide a powerful solution to manage both your business and your broking activities.

Overview Of SunSystems IA ledger functionality

This section provides an overview of some of the main functionality in the SunSystems IA Ledger. This is not an exhaustive list but serves to indicate the scope of the functionality included in the SunSystems IA Ledger.

Pay-as-paid

- Funds are only released to a carrier or client when they have been received from the other party.
- Claims are only settled to the client when funds have been collected from the carriers/underwriters who are bearing the risk.
- Premiums are only paid to the carrier/underwriter when they are received from the client.
- Creates linked sets of postings to represent a complete insurance transaction, with controls over maintaining the integrity of the link.
- When matching postings on one side of an entry, the system uses the Link Reference to identify and release postings on the other side ready for payment.
- Where postings are split, the system reflects the split on the other side of the transaction. Users are able to refer easily back to the original transaction from which the split was created.
- Facilitates the handling of levels within a hierarchy, particularly important for re-insurance.

Principal to principal

- Principal to Principal functionality enables clients to see the carriers to whom they owe money for premiums, and from which carriers their money is due for claims. Similarly carriers can see their position with each client. For example, this allows parties to see any money that is due in respect of a liquidated market.
- Supports hierarchical structures with many levels, including the capability for the same company to appear at more than one level. This supports the placement of money in the London Market where there may be several companies within several stamps for a bureau.
- Brokers can match and settle at different levels within this hierarchy. They can also report on and view postings at detail or summary levels and at any other level within the hierarchy.
- Detailed postings from billing systems are automatically summarized as required.

Complex multi-currency

- Up to four variable transaction currencies with option for fifth rate-based variable currency.
- Supports separate tracking of transaction currency, billing currency, banking currency, settlement currency and reporting currency.
- Full revaluation processing across currencies.
- Treasury Dealing functionality to record transactions that require Inter-Bank Currency Transfer Requests with matching when deals are made.

Statement production

- User-definable statement formats, with user-defined selection of statement content.
- Address selection by transaction type (premium or claim).
- Principal to Principal statements.
- Automatic and manual statement production.
- Various distribution methods (including print and fax, internet and e-mail).
- On-line statement agreement.
- Statement reference and counter function included for tracking.

The SunSystems IA Ledger also includes all of the functionality you would expect from a world-leading financial management system, including cash and bank account management/reconciliation, full journal posting management and control, and powerful inquiry ands analytic capabilities that leverage the Client, Underwriter and Third Party relationships to deliver summarized views from any perspective.

For more information

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