ENDING THE PAPER CHASE

APPLYING ELECTRONIC DATA INTERCHANGE

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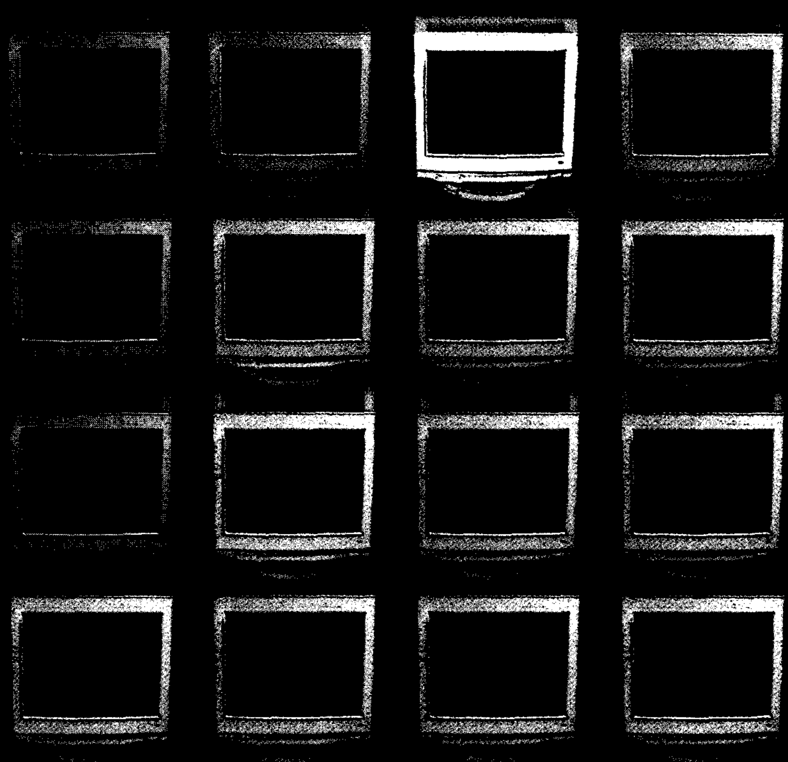


Even though personal computers are commonplace and the millennium is fast approaching, risk managers continue to find that their service providers generally conduct business in a paper-intensive environment, bypassing the tremendous opportunities provided by electronic commerce. As the manual processes that organizations use in their cash management, finance, treasury and sales functions are being replaced by more efficient electronic tools, risk managers have to be aware of this shift and its implications—not only to address the accompanying risks, but also to help their organizations reap the largely untapped benefits.

For example, risk managers can partner with their information management and other functional groups to automate transactions with brokers, insurers, reinsurers, third party administrators, captives and other service providers. Payment types can include premiums, audits, claims and fees.

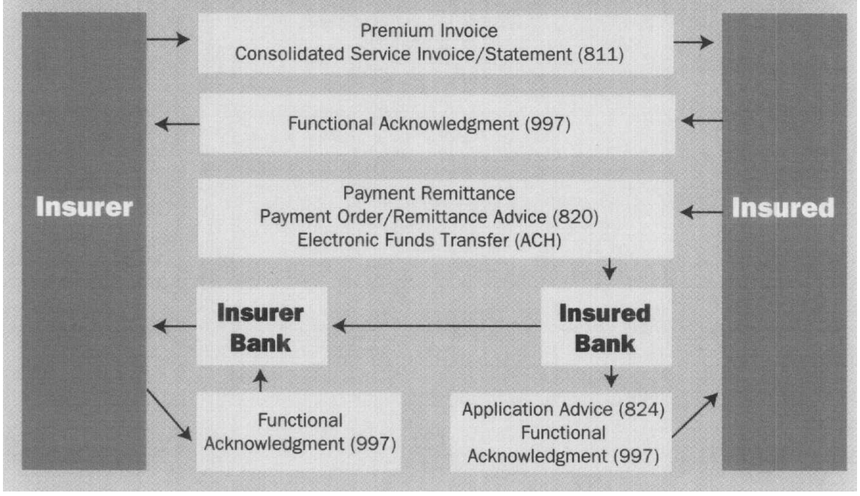
And while electronic commerce includes familiar components such as e-mail, electronic forms and technical data and documents, it also encompasses the fast-growing technology known as electronic data interchange (EDI)—the exchange of business information between parties via computer-to-computer transmissions.

EDI has been adopted by more than 120,000 companies worldwide and its use is growing every day. In many industries, business opportunities will be lost if a company is not "EDI-ready." Many vendors require partners to use electronic payments, purchase orders and invoices. This technology often ties in with point-of-sale or inventory systems. In fact, it is likely that many risk managers will find their organizations using EDI and that risk management-related functions can be added to this infrastructure rather easily.

The elimination of errors that can occur in manual data entry, and the time saved by not having to reenter data, can bring significant advantages to many organizations. EDI also provides consistent formats that make it easier to spot errors or missing information. Less tangibly, business relationships can be improved by the cooperation required to implement EDI, the enhanced trust that results from shared information, the elimination of nuisance factors (such as having to convert data between incompatible systems) and the ability to exchange payments more rapidly.

Managers concerned that conducting business electronically may present undesirable security concerns may be surprised to learn that safeguards built into EDI transactions can make this approach more secure than paper-based communications. Before partners begin trading electronically, guidelines are established to confirm that an electronic invoice is from an established trading partner, and that the amount and type of the payment, along with the payment instructions, are accurate.

EXHIBIT 1 Sample Transaction Premium Invoicing and Payment



Most risk managers already receive some types of information, such as claims data, paid losses and loss reports, from outside providers via computer transmissions. However, most of these transactions are based on proprietary software, and data are frequently not interchangeable between organizations. EDI provides a basis for transmitting business transactions in standardized formats across various computer platforms.

Because EDI provides more timely information for making decisions, more transactions can be completed without an increase in staff. Through better use of EDI technology, risk managers can reallocate time from administrative duties to professional activities.

Some of the savings associated with EDI are small, while others, depending on the number of transactions, can be significant. For instance, one of the most common business transactions is the payment of bills—generally by check or wire transfer. An electronic funds transfer (EFT) utilizing an automated clearinghouse (ACH) payment can be much less expensive than traditional methods. Across industries, the costs associated with the issuance of a check can vary from $1.50 to $8 (and may be even higher in some cases), while wire transfers can cost $4 to $50 apiece for domestic transactions and more for international transfers. In contrast, electronic ACH payments run from 6¢ to 50¢, with an average cost of about 8¢. Additionally, because of the electronic nature of these payments, errors and delays can be significantly reduced. This ultimately reduces the overall cost of payments.

Depending on the internal controls established by organizations, many daily, weekly or monthly repetitive transactions can be automated. For example, if a monthly premium or claim deposit fund reimbursement falls within a certain dollar range, it could be a likely candidate for EDI. Exhibit 1 demonstrates the types of transactions that would be required to pay a monthly premium invoice.

Software can automatically generate a return payment without requiring a risk manager or other employee to sign a payment request. Many auditors favor this type of computerized control over paper processing.

In addition to reducing the amount of time spent processing routine payments, EDI can also be a convenient way to input data into the organization's business applications, such as a general ledger or risk management information system.

Aligning Interests

To provide an open platform for electronic commerce, EDI standards must be set not between companies, but across industry groups. In 1979, the American National Standards Institute (ANSI) chartered the Accredited Standards Committee (ASC) X12 to develop uniform national standards that span all industries. More than 275 transaction sets have been established. Additionally, the United Nations has backed an international standard known as UN/EDIFACT.

To bring the benefits of electronic commerce to the risk management community, an insurance subcommittee has been created to develop and maintain standards relating to insurance coverages including property/casualty, health care, life and reinsurance and related processes such as reporting to regulatory agencies and contracting for risk management services. Some of these standards have been adopted, while others are being developed. Although certain groups have made significant progress, current use is more common among health care providers than within the property/casualty industry.

Through EDI standards, all transaction sets are named and numbered. Many of these existing sets have specific applications to risk managers and the insurance industry. These include: report of injury or illness (148); invoice (810); consolidated service invoice/statement (811); payment order/remittance advice (820); health care claim (837); and functional acknowledgment (997).

Getting Started

Several requirements must be met before companies can enter into EDI transactions. Organizations need hardware capable of running EDI translation software and linking to an outside network. Most organizations already have adequate equipment because EDI documents can be transmitted on systems ranging from personal computers to minicomputers to mainframes.

Additionally, organizations must have software capable of translating data into the EDI message format. This capability may already be integrated into existing business application systems or a separate software package may be utilized. Finally, communications capability through a value-added network (VAN) service (a company that receives and delivers EDI messages), an intranet or a direct Internet connection is required.

On a vendor-by-vendor basis, participants must also sign an EDI or trading partner agreement that provides the contractual framework for transactions and defines the responsibilities of all parties, including terms, communication standards, liability, fees and security protocols.

For instance, each party will adopt a "digital signature," which is an electronic identification consisting of codes or symbols that can be affixed to each document. This signature is used to verify the identity of the party originating the document. Properly established, EDI is generally considered to be at least as secure as the exchange of paper documents; EDI software includes data editing and error-checking methods to ensure that the data is valid at the time of transmission and also upon receipt. A functional acknowledgment, a transaction set that acts as a "read receipt," should be required to provide the first line of control by signaling that the other party has received the EDI documents.

The implementation of EDI may require a fundamental shift in organizational thinking. Senior managers, along with internal and external auditors, need to be comfortable with EDI and its associated controls. Business systems may need to be retooled and significant investments in hardware and software may be required for those organizations that are not EDI-ready. However, once an organization signs onto EDI for one operation, the feasibility of using electronic commerce in other functions should be explored.

This exploration is long overdue in the risk management community. Although EDI has been evolving for some time, insurers, third party administrators and brokers have not generally been at the forefront in advocating this technology; most of them have opted instead for proprietary systems. But as risk managers are asked to do more with less staff, reduce costs, improve efficiency and adjust to changing conditions, these demands can be met effectively through the benefits offered by EDI. Risk managers should integrate EDI to its fullest potential as soon as their organizations permit and urge their business partners to do likewise. RM