INSURANCE

CONNECT TO THE FUTURE OF RISK MANAGEMENT: GETTING THE BEST FROM IFRS 17

MARTIN SARJEANT
GLOBAL RISK SOLUTIONS LEADER, INSURANCE, FIS

OSCAR WEAFER
ACTUARIAL SOLUTIONS LEADER, INSURANCE, FIS

JOHN WINTER
DIRECTOR OF PRODUCT MANAGEMENT, INSURANCE, FIS

NEIL COVINGTON
DIRECTOR OF SOLUTIONS MANAGEMENT (GI), INSURANCE, FIS
Contents

2   Introduction – A brave new world of insurance accounting
2   Put people first
3   Modernise actuarial systems
4   Play by finance’s rules for data
4   Improve automation and workflow
5   Manage your business better
6   Reasons to welcome IFRS 17
8   Conclusion – Are you ready to rise to the connectivity challenge?
Introduction – A brave new world of insurance accounting

The International Financial Reporting Standard for insurance contracts (IFRS 17) is the latest potential disruptor to business as usual for insurance companies. But if implemented properly, the accounting standard will not only deliver numerous benefits for financial reporting, but also add significant business value by improving the efficiency and governance of processes and risk management.

So, with implications for your people, processes, systems and data, what exactly does this new approach to accounting mean for your insurance business; how will you ensure compliance by 2021; and how can you realise genuine benefits for your business?

Look beyond the calculations to connectivity and collaboration

IFRS 17 will officially come into force on January 1, 2021, in more than 100 countries around the world. Developed by the International Accounting Standards Board (IASB), this new, near-global standard represents a fundamental change to insurers’ accounting regime and, as a result, will involve a new set of actuarial and financial calculations.

Specifically, IFRS 17 will change the way that insurers measure and report their profits, requiring them to value insurance contracts based on current fulfillment value, not book value.

For actuaries especially, the calculations that underpin IFRS 17 will form only part of the challenge. IFRS 17 may be an accounting standard, led and managed by the finance function, but it will also require insurers to demonstrate more controlled, connected processes for creating key IFRS 17 metrics.

By bringing actuarial models and calculations into the heart of financial reporting, IFRS 17 will introduce complexities that fundamentally challenge existing insurance operations – demanding new solutions and greater connectivity and collaboration between the actuarial and finance functions.

Put people first

With its fundamental requirement for finance and actuarial teams to work more closely together, IFRS 17 demands a particular focus on people, and will represent a significant cultural shift for many organisations. That makes it more important to put together the right team from the outset, as cost-effectively as possible.

When it comes to drafting in talent, we can learn important lessons from the way that European insurers tackled the Solvency II Framework Directive. As a game-changing regulation for the insurance industry, Solvency II commanded immense budgets that, in turn, attracted not only hordes of external contractors but also multiple in-house IT initiatives. It’s fair to say that, in some cases, costs and scope spiraled out of control – and largely down to poor coordination and management.

So, if Solvency II teaches anything, it’s that leadership and project management are key to managing your resources in times of regulatory change. Unless IFRS 17 is managed carefully from the beginning, it will be all too easy to follow the same pattern of sending “all hands to the pump”, overloading teams and mistaking spending money for making progress.

What’s more, for firms with disconnected finance and risk management functions, IFRS 17 will require a complete finance transformation. New working relationships and cross-team collaborations don’t happen overnight and will be challenging to establish without a strong facilitator and the guiding hand – and buy-in – of senior management.

Another lesson of Solvency II, not to mention basic economics, is that if demand exceeds supply then prices will rise. For a large part of the implementation period, Solvency II saw demand for IT and actuarial resources far outstrip supply, pushing up costs for firms that were late to implement – and compromising the quality of available resources, solutions and results. Some markets with a limited talent pool are already facing the same problem with IFRS 17.

Taking all these experiences into account, it’s important for insurers to start planning their approach to IFRS 17 right away, engage management early and, with the right leadership on board, communicate a clear mandate for change. Strong project management throughout, with robust budget controls and change management processes, will be vital, as will the early hiring of talent to fill any gaps in skills.
To mitigate risk, we would also recommend that insurers look to the expertise of technology providers, who can assist through a combination of specialist solutions and services.

As well as dramatically reducing costs, total cost of ownership and time to market through automation, technology solutions will free up whole teams to focus on the finer points of the regulation. They also come backed with a global skills base and consultancy support that can help resource IFRS 17 projects. Why reinvent the wheel and stretch your own resources when the solutions and expertise are out there already?

**Modernise actuarial systems**

For many insurers, actuarial systems could be much the same today as they were not only five, but also 20 years before. Now, with so much at stake, it’s high time to bring ageing software up to date.

Today, actuarial systems are critical to businesses and should be used to underpin strategic decision-making, not simply as a risk reporting system for regulators. To get the most value out of these risk management tools, insurers need to make sure they are embedded across their organisation and controlled centrally by a qualified IT team. In many regions, however – and particularly those yet to experience Solvency II or equivalent levels of regulation – this requires a complete change of mindset.

For these hitherto less regulated territories, IFRS 17 will come as something of a shock to the (risk) system. A jumble of antiquated solutions held together by “band aids” and in-house “glue” will lack the control and cohesion that IFRS 17 compliance demands. Instead, you’ll need a system with the following attributes:

- **Connectivity** – The production of IFRS 17 numbers will rely on actuarial systems to perform the calculations and accountancy systems to consume and report the resulting data. This in turn requires the two systems to be carefully integrated and orchestrated together, supporting close collaboration between actuaries and accountants.

- **Governance** – Everyone working with data produced by the actuarial system needs full confidence in its calculations and a system that is not only well controlled but also has strong controls and auditability built in.

- **Mission-criticality** – IFRS 17 puts actuarial systems front and centre of its reporting requirements, the weight of which desktop platforms and glued-together processes will struggle to support.

- **Automation** – For Solvency II and similar regimes, many insurers have already implemented a “fast close” process, compressing the time needed to complete a period-end run. First, you’ll need to document all the processes and people involved in producing actuarial reports. Having streamlined those processes, you should then be able to automate them through APIs that expose key attributes and enable workflow software.

- **Reputation** – Is your platform’s vendor committed to continual improvements and embracing new technologies? IFRS 17 will not be the last accounting change and technology will not stand still either. So, you need to be sure of your vendor’s reputation and ability to accelerate improvement, reduce operational risk and lower cost of ownership with a strong end-to-end solution.

- **Speed and scalability** – IFRS 17 will create additional reporting requirements for all insurers and may be computationally intensive compared to other regulatory reporting, especially if you do not habitually carry out large asset liability management (ALM) runs and stochastic investigations. Certainly, for all insurance companies, life and non-life, the level of detail that you need to report on will increase. Internal stakeholders are also ever more reliant on the results produced by actuarial systems to deliver new business insight. Can your system deliver the speed and scale to meet these new demands on computing power and data?

Above all, start thinking about these requirements right now. Risk management systems cannot be installed overnight and an enterprise actuarial solution will help deliver constant business value across the whole spectrum of actuarial and risk analysis – from product pricing, reserves and valuations, through ALM and capital projections, to driving multi-year business plans.
Play by finance’s rules for data

As an accounting standard, IFRS 17 demands unprecedented levels of connectivity and collaboration between insurers’ actuarial and finance departments, especially in the way they manage their data. This means actuaries will now need to apply finance’s rigorous standards of control to actuarial modelling.

Accountants’ financial controls have been under the regulatory microscope since the WorldCom and ENRON scandals, leading to legislation like Sarbanes-Oxley that insists on efficient, documented controls. Under the increased demands of IFRS 17, actuaries too will need to demonstrate robust controls, audit trails and systems – and less reliance on unmanaged spreadsheets and processes. More specifically, they must:

• Provide for common assumptions information, shared between accounting and actuarial systems, with a clear link between the input assumptions and the calculations that use them.
• Ensure reproducible and traceable results, with locked-down data that demonstrates links between inputs and outputs.
• Add governance data to reporting data, so that reports can show not just results, but the steps and approvals that led to those results.
• “Translate” the large, distributed data sets produced by actuaries into the specific values needed by the finance team, through controlled mapping mechanisms.
• Implement robust reconciliation processes to check the completeness and accuracy of any data transfers between systems.
• Allow for both volume and granularity in data retention and storage policies. Each new regulation requires new metrics to be calculated, increasing the amount of data that needs to be stored, and IFRS 17 is no exception.
• Put in place a controlled, documented process for any mechanisms used to make actuarial adjustments to data before it is published.

By following these recommendations for data management, insurers will be in a far stronger position to achieve compliance with IFRS 17. But there is a greater opportunity here, namely, for actuaries to move their data systems and processes into the same, premier league of governance and control as the finance department. This will, in turn, help increase efficiency, ensure accuracy, support collaboration and, above all, create a more robust and meaningful framework for risk management.

Improve automation and workflow

Automation and workflow improvements have long been on actuaries’ “to do” list, but are often left for a time when work eases off. Ironically, the very lack of workflow solutions can explain why this time never comes. Now, IFRS 17’s emphasis on audit and control makes it more important than ever to reduce manual actuarial and risk management processes.

There are two more reasons why insurers should increase automation. First, the senior managers of today’s insurance companies are increasingly interested in the risk metrics of their business, which means more modelling runs, data analysis and pressure on actuarial processes. And second, insurance margins continue to tighten – so, rather than hire more actuaries to ease the pressure on processes, firms need to make existing teams more productive through automation.

There are also good reasons why – unlike their finance colleagues – actuaries have largely resisted adopting automated workflow solutions until now. In contrast with highly standardised financial close processes, period-end processes for actuaries vary widely from firm to firm. The models are different, and so are the data requirements, making solutions complex to implement.

Despite these variations, actuarial processes at period-end do follow a common sequence that lends itself well to automation and should be the focus of any workflow solution to IFRS 17:

• Data gathering and enrichment – collation of data from a range of input systems, both internal and external, and including policy and claim administration systems, finance systems and economic scenario generators
• Assumptions setting – although sometimes part of the data-gathering process, assumptions often require formal approval before use and introduce extra stages in the business process
• Model execution – running the model using the data and assumptions gathered (and optionally approved)
• Aggregation and contextualisation – summing up the results of the modeling process at the level expected by the business, frequently combining data from other sources to add context
• Results analysis – checking the results against expected values or cross-checking one set of results against another, sometimes automated but often significantly manual
• Dissemination – publishing the results to the business and regulators, usually via a third-party tool such as a business intelligence engine
The actual business process surrounding each stage can vary, with some firms requiring manual approval at certain points, or automated “sanity checks” to ensure that results are not wildly different from expectations. Physical implementation can differ too, with a variety of systems being used to carry out every stage, particularly data gathering and dissemination.

It is also vital to remember that the sequence described above represents an ideal world where everything goes according to plan. Any workflow solution needs the ability to follow not only this path, but also all possible exceptions – when a stage is missing data, fails or is overdue. When setting up business process definitions, you should pay a lot of attention to managing both exceptions and escalation, to ensure you never miss a reporting deadline again.

Lastly, nothing in the world of actuarial science is constant. The recent uptake of cloud technology has been incredibly fast – from flat refusal to whole-hearted acceptance in less than five years. Focusing entirely on building a process for IFRS 17 may lead firms to create a rigid workflow, with hard-coded stages that hamper the adoption of emerging working practices and technologies. So, while automation matters hugely under IFRS 17, a flexible framework for workflow can be just as important in the long run.

Manage your business better

Like Solvency II before it, IFRS 17 will create a more complex reporting regime for insurance practitioners. But when it comes to putting the right financial system in place, it could be a costly mistake to focus purely on initial reporting requirements and the feeding of actuarial calculations to finance. Importantly, you’ll also need the tools to manage your business effectively under the new regulation.

Beyond reporting, IFRS 17 is set to transform the way that insurers deliver value and protect the interests of customers, shareholders and other stakeholders. So, it’s imperative that actuaries and finance teams are equipped appropriately across the board – whether for pricing contracts, business planning or active risk management.

Most fundamentally, any system under IFRS 17 will require the ability to make future projections for these purposes. When considering a solution, ask yourself:

- **What should I project?**
  There can be considerable overlaps between the reporting requirements of regulations such as Solvency II and IFRS 17, so it’s logical to integrate these calculations within a single business projection. Centralising your models – and where possible, your assumptions – will reduce maintenance duties, the risk of divergence and inconsistencies.

- **How far ahead must I project?**
  For short timespans, a cash flow model equipped to perform embedded balance sheet valuations will provide all the information required. For longer periods, a more pragmatic approach may be suitable and a higher level of approximation allowed for. This approach will make validation and calibration more costly but will improve runtime performance.

- **How should I perform projections?**
  Typically, where possible, try to reduce the volume of calculations required for embedded balance sheet valuations. You could do so simply by grouping policy data when moving from experience to valuation models during the projection – or integrating lighter models. In general, a more granular level of detail within the experience projection will help capture the scenarios being tested more accurately.

- **Which reporting measures should I cover?**
  Include any metrics that provide insight into your business’s performance. The contractual service margin (CSM), for example, measures future profitability and is sensitive to changes in assumptions. In projection terms, CSM can therefore indicate the impact of “what if” scenarios on the business’s future profit stream. But risk capital is also likely to play a large role in this stream and a projection system should allow for switching between heavy (e.g., cash flow) and light (e.g., proxy) approaches.

As insurers plan in earnest for IFRS 17 implementation, there is a big risk of overlooking these essential wider system requirements – and missing a key opportunity to increase profitability and reduce costs. By thinking in concrete terms about how to manage your business under the new regime, you can make IFRS 17 as much about improving your numbers as reporting them.

Actuarial processes at period-end do follow a common sequence that lends itself well to automation and should be the focus of any workflow solution to IFRS 17.
Reasons to welcome IFRS 17

With concerns over costs and a perceived lack of benefits among some insurers, there’s a prevailing mood of doom and gloom about IFRS 17. But rather than striking a deathly blow to the balance sheet, many believe the new accounting standard for insurance contracts spells good news for insurers and stakeholders.

From this radical “glass half full” viewpoint, here are seven big benefits that IFRS 17 will bring to the insurance industry and individual insurance companies:

1. **Liabilities valued at market value**
   By bringing the valuation of insurance contracts in line with both the assets that back them and valuations made in other industries, IFRS 17 will instigate better product design and greater transparency. As IASB chairman Hans Hoogervorst explains: “Proper accounting shines light on risks that might otherwise go unnoticed – both by companies themselves and by investors.” So, although the standard may appear initially to weaken some insurers’ balance sheets, it will actually encourage better pricing of insurance contracts and strengthen the balance sheet over time.

2. **Truer reflection of profits**
   In some jurisdictions, insurers have designed products to maximise early profits. For example, if an insurer sells a 10-year insurance contract, with premiums paid for one year, it generates massive profits in the first year and then small losses afterwards. IFRS 17, by contrast, measures profit in line with services performed and spreads it over the contract’s life in a series of smaller cash flows – giving more insight into how profit emerges. The standard also excludes deposit coverage from revenue calculations, which will especially affect the accounting of thinly veiled savings contracts – and, again, help better reflect reality.

3. **Nearly global consistency**
   A consistent and high-quality accounting standard for all insurance contracts across most jurisdictions has to be a good thing. For multinational insurers, in particular, it will reduce the long-term costs of compliance and make it easier to compare business units and aggregate results and financial statements. What’s not to like?

4. **Collaboration between actuaries and accountants**
   Both actuaries and accountants look after the interests of stakeholders and help manage insurers’ finances and risks. But in many organizations, these are still siloed functions with little interaction or understanding of each other’s activities. IFRS 17 will drive them to work together and establish mutual respect and cooperation, which again can only be good news for stakeholders and improve the way the company is managed in the future.

5. **Better governance of actuarial systems**
   For more than a decade, many insurers have been raising their governance game and reaping tremendous benefits such as lowering operational risks and reducing ongoing costs. Others, however, continue to use actuarial systems without the control and automation that IFRS 17 demands. Improving governance standards will not only help achieve compliance, but also reduce costs, minimise manual errors and make it easier to access risk insight, all leading to better management of the business.

6. **Greater protection for policyholders**
   IFRS 17 will help strengthen insurance company balance sheets and offer more protection to policyholders as a result.

7. **Investor confidence**
   All the above improvements to the accounting standard give investors proper insight into insurance companies, allowing them to compare one firm with another on a more consistent basis. This can only improve investors’ confidence in and understanding of insurers – surely another reason to be cheerful.

Beyond reporting, IFRS 17 is set to transform the way that insurers deliver value and protect the interests of customers, shareholders and other stakeholders.

---

1 IFRS, IASB CHAIRMAN’S SPEECH: IFRS 17 AND ITS CONTRIBUTION TO FINANCIAL STABILITY, JUNE 2017
Conclusion – Are you ready to rise to the connectivity challenge?

With new calculations, the grouping of contracts, shorter timelines for reporting and extra disclosure requirements to manage, IFRS 17 will demand new levels of speed, flexibility, analysis and, above all, connectivity from insurers. As a result, many insurers will need to fully review their whole infrastructure. Specifically, they must look at how IFRS 17 requirements will interact with their existing reporting activity and how they might reduce reporting times and increase governance in the future.

Beyond its reporting and calculation requirements, IFRS 17 is likely to considerably transform the way that insurance companies work. The actuarial calculations for IFRS 17 will now effectively drive a company’s profits, tying the function much more closely to the whole financial reporting process. This will force traditionally siloed teams to collaborate more effectively and drive management to ensure that actuarial systems are well governed and connected with finance systems.

Insurers will need to make unprecedented improvements to the governance of actuarial systems and the connectivity of those systems to the general ledger and finance department. Interaction between the actuarial and finance functions will also need to increase to levels not needed before. For some insurers, particularly those not yet subject to Solvency II or its regional equivalents, there will need to be a complete step change to governance levels.

Now, as the compliance deadline of 2021 approaches, more firms are realising that a robust production environment, sound assumption management and an efficient, controlled and highly integrated process platform will be central to an effective IFRS 17 implementation. Arguably, the calculations are the simple part – the true challenge is managing and completing the overall process effectively.

There is also the realisation that, when done properly, this long overdue revamp of systems and processes can achieve more than just compliance. With greater end-to-end control over processes, insurers could add value by improving efficiency, transparency and the strength and availability of management information. Ultimately, this will help support profitability, shareholder value and rating assessments.

The time is ripe for operational change. With a solid, seamlessly connected foundation of systems and processes, you’ll be in a stronger position to not only ease the pressure of IFRS 17 but also reap long-term business benefits. Are you ready to rise to the challenge?

About FIS’ Prophet solution

Prophet is a leading enterprise-wide actuarial modeling system that helps insurance and financial services companies meet reporting responsibilities, improve risk management and develop more profitable products faster. Prophet uses customizable actuarial libraries for all major product types, including regional variations. It provides the transparency, performance and control required by today’s actuaries and risk managers through integrated financial modeling and data management capabilities. Prophet is used by more than 10,000 users at over 860 customer sites in more than 65 countries.

About FIS

FIS is a global leader in financial services technology, with a focus on retail and institutional banking, payments, asset and wealth management, risk and compliance, consulting and outsourcing solutions. Through the depth and breadth of our solutions portfolio, global capabilities and domain expertise, FIS serves more than 20,000 clients in over 130 countries. Headquartered in Jacksonville, Florida, FIS employs more than 55,000 people worldwide and holds leadership positions in payment processing, financial software and banking solutions. Providing software, services and outsourcing of the technology that empowers the financial world, FIS is a Fortune 500 company and is a member of Standard & Poor’s 500® Index. For more information about FIS, visit www.fisglobal.com.