A once-in-a-generation opportunity for business change

IFRS Essentials

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A once-in-a-generation opportunity for business change

IFRS 17 offers companies the chance to revamp their business processes for their long-term benefit. Mark Miller, IFRS global lead, and Jeremy Wood, chief executive, of Legerity explain how

> "IFRS 17 offers a once-in-a-generation chance for positive change."

IFRS 17 is the biggest accounting change to hit the insurance industry for many years. There is no doubt that the regulation presents a challenge and will entail a significant amount of work and expenditure for an industry that has only recently finished with Solvency II implementation.

However, at the same time, IFRS 17 marks an opportunity to upgrade financial processes and infrastructure, bringing the potential of huge benefits for the insurance business. Implementing the standard means investing: make those investments wisely and the industry will not just be complying with regulations but upgrading its entire business process architecture.

We believe that the benefits offered by a dynamic, forward-thinking and comprehensive IFRS 17 implementation vastly outweigh the short-term pain. In this paper we outline how and why insurers should be embracing the challenge of IFRS 17 to boost the long-term future of their businesses.

Why invest? What benefits?

IFRS 17 provides an opportunity to benefit across many different business areas. It is much more than a technical issue and the impact will be felt well beyond finance. From data management to automation, people skills to standardisation, business planning to product design, forecasting to remuneration policies, the regulation has the potential to truly revolutionise an insurer's business processes.

At the same time, companies which might not have fully benefited from the Solvency II business case to implement an end-to-end solution will have this opportunity with IFRS 17. Many insurers will be left with tools that are not integrated, inefficient reconciliation processes and imperfect data structures. Implementation of the standard can be used to redesign and undo some of the old, less efficient choices.

Transparency

A fundamental goal of IFRS 17 is to ensure transparency and comparability across the industry. In order to achieve this, the regulation obliges companies to pursue a principles-based standardised approach. Under IFRS 4 a myriad of accounting principles were allowed. In the new standard, consistent approaches are prescribed for liability measurement and profit recognition.

The default measurement approach is the Building Block Approach (BBA). A simplified version is allowed in some circumstances called the Premium Allocation Approach (PAA) and there is a variation of the BBA for contracts with participating features called the Variable Fee Approach (VFA).

Although insurers do have some choices to make for these, the overall framework will be transparent to readers of the financial statements and consistent, with many general insurers electing to use PAA and the life industry following BBA. IFRS 17 also makes it much clearer how the impact of underwriting versus financial performance effects the results, with the option to show financing impacts in the statement of Other Comprehensive Income.

The application of IFRS 17 will make it easier for companies to compare their performance against competitors and for shareholders to benchmark company performance with industry peers. For insurers with global footprints and multiple business lines, IFRS 17 offers a more consistent means to understand how different parts of the business contribute to performance. IFRS 17 will also make it easier to make historical comparisons and to better analyse future impact of business decisions.

Process efficiency

Currently new policies are booked at the month-end and it might then take a few months before views on liabilities are taken. Under IFRS 17, companies will have to take a forward-looking view of polices at inception, pre-calculating a view on the net economic benefit of a contract. The requirement to measure and book liabilities on day one gives a faster view of the impact on financials of new business written.

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It will be an upfront effort in the future which is not without complexity. You are defining and pricing new products at the start and recognising profit over time based on coverage. This requires factoring in many different elements in revenue calculations which can also be very far out in time. But doing this will have the benefit of improved timelines and efficiency for month-end. It streamlines getting to the initial view of company performance.

Projections of future cash flows can be stored in the accounting sub-ledger along with the expected accounting releases. This gives the business a rich source of data to analyse and understand expected future results. Such information will be invaluable for scenario analysis, business planning and budgeting and decision making.

In defining these new reporting processes, IFRS 17 offers a chance to review and standardise across the organisation. The implementation should involve defining common data extracts, data flows, rules and calculations, data structures and common technology, including new generation accounting rules and calculation engines, even across global footprints.

IFRS 17 will drive more than just consistent recognition and measurement: it should also drive standardisation of how those financial results are produced. If such an exercise is done well it results in a highly efficient centralisation of processes which in turn can support great levels of cost saving from outsourcing.

Upgrading the finance back office

Technology, systems and processes have moved on rapidly in many aspects of the insurance business. Despite the investment in Solvency II, change in the finance back office has been slow to come. It is rare that you find the back office at the forefront when it comes to receiving investment. Finance back office processes have tended to be left behind and not accorded the same levels of investment that have gone into other areas. IFRS 17 will change this. The focus on the financial function gives insurers the chance to finally make their back offices modern and efficient.

> "IFRS 17 is exactly the opportunity that the back office needs to give it the chance to shine."

Bridging the gap between actuarial and finance

The new standard will require actuarial modelling work to be more transparent to people in finance. For many, it is a truism that actuaries do not know the financials while accountants do not know how to explain the assumptions behind the financials.

In the past, insurers seeking to gather information for decision-making purposes have mainly relied on substantial input from the actuarial department. In consequence, finance may not be fully aware of unprofitable business and actuaries may not know when or how to highlight issues for reserving – reserves could even be incorrect as a result. Often the only person who has the overall picture of the business is the chief financial officer. This will need to change post implementation.

Ensuring closer connection between the actuarial and finance departments offers a means to better manage data and actuarial outputs. Insurers will be able to see greater detail in their financial results – what is driving changes in data – which, in turn, filters down to create better auditability and transparency.

The technology play

In many cases finance relies on outdated, fragmented technology. This can mean important processes may have to be run overnight and are vulnerable to failure which can then impact month-end calculations and take a significant time to re-run.

IFRS 17 will involve a lot more complicated processing and heavy transaction runs. Insurers will need to have more processing power to enable this.

Enterprise Resource Planning (ERP) platforms will, in many

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cases, have been in place for years. Such older and outmoded technology is unlikely to serve the purpose of the new regulations and indeed the rapidly evolving global market environment. However, changing or upgrading technology is not always the easiest of tasks. Companies can be discouraged from altering or replacing legacy systems because of the cost to do so and face internal obstacles to overcome this. Full replacement ERP may not be an option but consolidating the IFRS 17 processes around technologies like ultra-fast rules and calculation engines is a very viable option.

Luckily, IFRS 17 comes at a time when technology is rapidly evolving. From cloud computing to more powerful in-memory processing, information is able to be stored, accessed and processed far more rapidly and efficiently than in the past.

The advent of new technology means that insurers can now slot ultra-fast rules based accounting and calculation engines, like Legerity FastPost, into existing system architecture in a more cost-effective manner. While investment is required, modern technology solutions offer better value for money than in the past to allow this benefit.

Technology investment will provide more efficient consolidated financial processes, which are designed to offer value for years. Insurers will be able to use IFRS 17 not only for the core regulatory work but also for other processes that remain fragmented and are vulnerable to failure.

Companies can take the chance to put in ultra-fast, forward looking technology now to go beyond IFRS 17 and assist with these other processes. Moreover, carrying this out as a regulatory compliance exercise will help to get over some of the internal barriers of upgrading technology that currently exist.

> "Investments made now can leapfrog you into the future."

Data quality and automation

By and large, the finance function has traditionally managed data manually, using spreadsheets. Finance will often download data to produce journals and reports. Management information (MI) reporting tools and the legacy systems that provide this data run off multiple platforms, can be slow and suffer from poor data quality. It means the ability of finance to get data for the month-end is often slow and inefficient.

Many insurers may close their books by the third working day but it may take many further days before the final results can be reported. As well as relying on responses from actuaries and slower processes, companies are often reliant on Access and Excel-based manual data reporting all of which can slow the acquisition of data for month-end.

This means that insurers will often not get a view on the consolidated results until 10 to 15 days after the closing of the ledger. There is also a real challenge turning MI outputs into supporting financial information for analysis and explanation.

Streamlining data using automated technology processes will improve the month-end information gathering process. By centralising resources into one place with the latest technology, companies will be able to save themselves from being reliant on outdated extraction routines.

To comply with IFRS 17, this process will have to be automated. Automation means using high quality automated data extracts and running these on high tech processes and systems. Fixing errors manually will not be viable in future. Investments will have to be made in solving data quality issues at source.

IFRS 17 places much greater emphasis on using a wide range of data to drive results. The rules demand increased transparency from insurers on all aspects of their financial calculations. Hence, underlying the use of technology is a requirement for accurate and comprehensive data. Insurers will have to improve the quality of data needed for their inputs as well as their calculations. It will become obvious if the input data is not working.

Getting good quality and timely data entails upgrading not only accounting systems, but also actuarial and source systems. Automation is the key to this. It will have huge benefits to help manage the business far more efficiently than in the past.

> "By implementing IFRS 17 you have, probably, to upgrade to better technology. But any automated system requires good data. What you need to drive IFRS 17 is to invest in the quality of your data as well as in the link between processing systems."

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Focus on people

IFRS 17 obliges insurers to understand more about their policies and costs from a wider angle, and aims to break down the silos between the actuarial and finance functions.

In future, finance will need to be working with actuaries on a more integrated level. At the same time, management will have to communicate differently, looking at the entire company, which means they will require greater input from finance for information and explanation than in the past.

Stemming from all this is the fact that finance will, in future, undoubtedly have a much stronger business partnering role. The function will be less about number crunching and processing, more about understanding and having relationships across the business.

There will be a lot of knowledge to be gained from those working in the programme. It can be leveraged to allow the finance function to grow into their enhanced business partnering role. While there is a training cost to this it offers opportunity for career progression and a widening of skills.

IFRS 17 implementation will offer insurers a much better view of the contribution of finance to the business across a whole range of dimensions. Post-regulations, decision-making will rely more heavily on the financial department than it has before. Finance will have much more detail in the sub-ledger on how new and old business is impacting financials without having to wait on actuaries.

At the same time, the role of actuaries in the outcome of the business is being made more explicit. The choices they make are more visible in the reported numbers. It calls for a change in the relationship between actuarial and finance, from data and assumption exchange to one of common understanding and collaboration.

Conclusion

The January 2021 deadline for IFRS 17 is barely three years away. If they have not already, insurers need to begin the process of implementation very soon. While this might cause additional work in the short-term we believe that it offers huge benefits from a business and operations perspective for many years to come.

Having an eye on improving future business processes is crucial. We believe that IFRS 17 is a catalyst to drive additional business benefits for insurance companies. Those willing to take the synergies and structure their implementation time and effort into process change and modern technology will see the benefits for many years to come.

The key is to strive for what we term World Class Finance and bring all different functions together.

IFRS 17 is the opportunity the industry needs to make this happen. ■

Legerity FastPost is a third-generation accounting rules platform designed to help insurers meet the complex finance challenges of IFRS 17. For further information visit: www.legerityfinancials.com or email info@legerityfinancials.com or call +44 (0)20 7997 6985

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