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Three simple ideas can take the panic out of your prep for IFRS 17

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Introduction

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Insurance companies have less than three years to adopt the International Financial Reporting Standard issued in May 2017 (IFRS 17), and many executives are struggling to get their hands around the technical and operational challenges they're facing. The changes IFRS 17 imposes are so fundamental and sweeping that some leaders might be worried they won't have time to make the necessary adjustments.

IFRS 17 will require companies to overhaul underlying account systems. It introduces a new measurement of insurance liability (contractual service margin) and makes risk adjustment and discounting of future cash flows necessary. The operational impact is considerable: additional policy and reinsurance data will be needed, more granular cash flow will have to be analysed, and new presentation and disclosures will be required. Designing new technical systems to integrate all of these changes will be especially difficult because of legacy systems and bespoke workarounds that many insurance companies have put in place over the years through multiple acquisitions and tactical fixes.

But there are steps you can take to navigate these changes. The first is to look beyond the technical interpretation of the standards and give attention to the operational impact of IFRS 17. In this article we'll discuss the core decisions and ideas you should consider early on to make sure your company's operations can adapt and thrive under the new rules.

Take a ‘soft design’ approach

Many insurance companies have already conducted an IFRS 17 impact assessment and so, at a high level, understand the gap between what they have and what they need. Where you might be stuck is in making the leap from impact assessment to implementation over the next three to six months. You might be wrestling with how to set the foundation for IFRS 17, build a business case, and develop a blueprint for your organisation that translates your vision, principles and requirements into an early-stage design. To succeed in these endeavours, we advocate taking a ‘soft design’ approach to the implementation.

Soft design is a flexible way of working. It builds on the principle that you must be able to tweak your plan along the way. If your company waits for the perfect solution before beginning to execute change, you’ll surely run out of time. So, soft design allows you to get started but identifies points when you can course correct as you proceed on your IFRS 17 journey.

Begin by making working assumptions about systems and architecture based on an understanding of process, data and control requirements. This includes anticipating problems and possible solutions. For example, what if the data quality is insufficient? What happens if you cannot reconcile IFRS 17 and Solvency II (SII)? How will you plan and forecast the contractual service margin (CSM)?

We strongly recommend that before you lock into a final design and build, you field test your design with proof of concept,

prototyping and sandboxing. It's best to do this using existing internal tools and selectively use proof of concepts with vendors to improve your understanding of the requirements.

For soft design to be effective, you need to follow three well-established management principles.

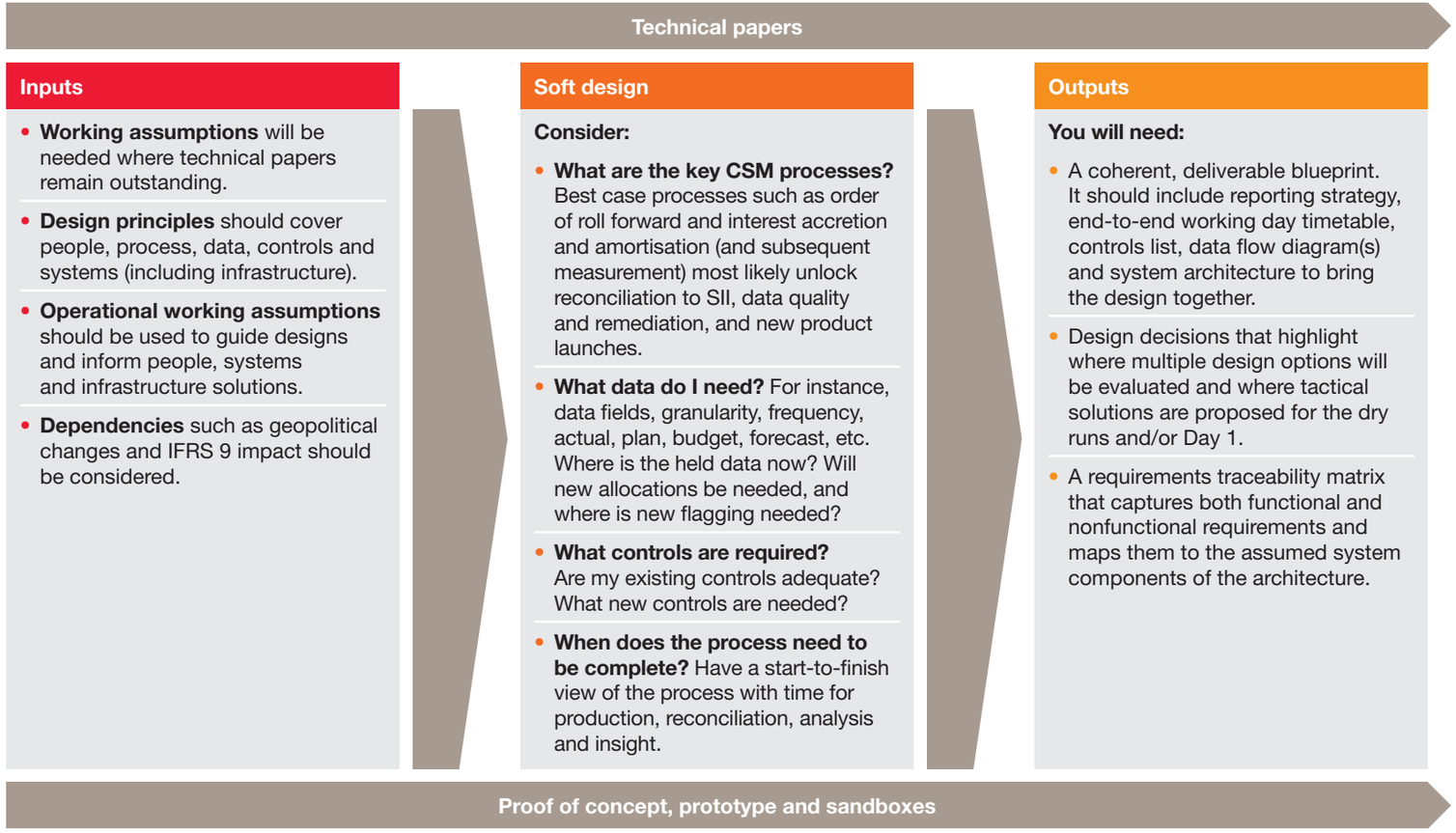
Think right to left

Don't make changes to comply with IFRS 17 without first knowing your end goal. Articulate and document what that goal looks like for the organisation and then work backward from systems and structure all the way to the platform needed for reporting. Otherwise, there will be a lot of last-minute scrambling to achieve goals.

For example, when Solvency II's programs were kicked off, many companies focussed on immediately building the actuarial solutions' internal model. Many hadn't thought through the data requirements for disclosure and reporting, and late in the game they realised that what they'd built wasn't sufficient to give the regulators what

Apply lessons from Solvency II

Consider the **technical papers alongside the operational impact**. Avoid focussing on systems too early, and instead work to understand the **process steps, data requirements and associated controls** and create a timetable. Keep your target in mind – which solution (process, data and control requirements) would best support the technical requirements of CSM and not compromise the timetable?



Source: PwC

they needed. A slight panic ensued in the last year or two before Solvency II took effect, as companies worked to source data and build reporting solutions. This was a product of thinking left to right, of not fully understanding the end goals from the start.

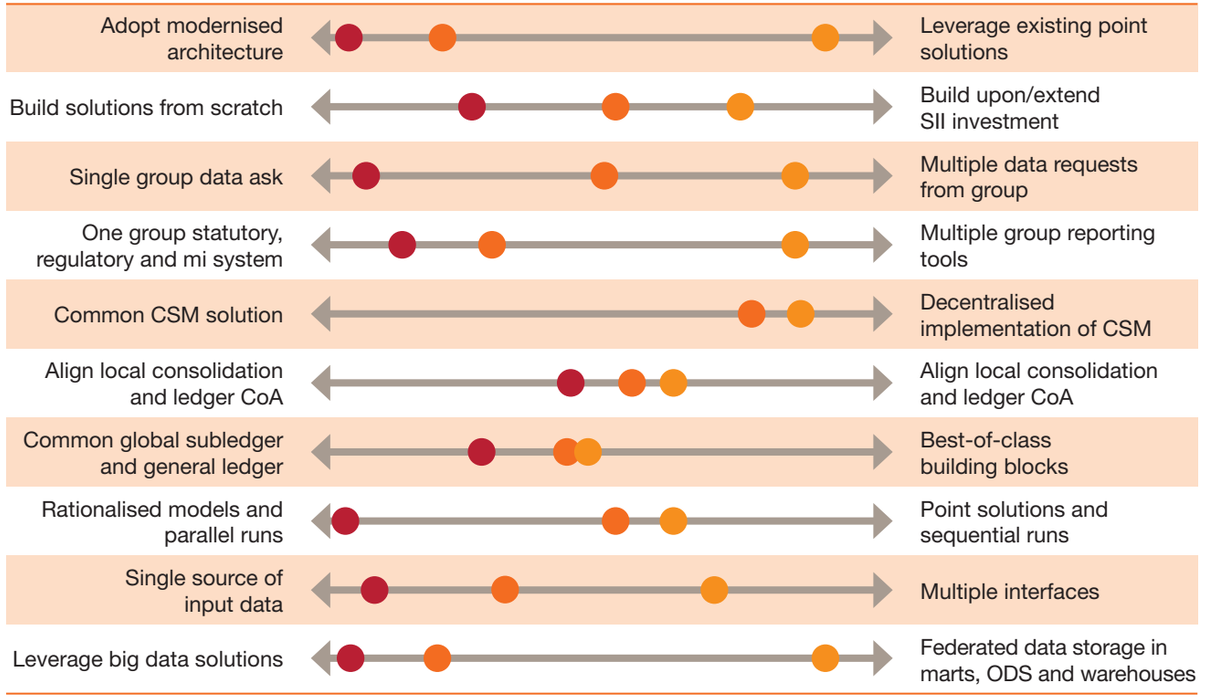
Establish governance

Take the top brains from each relevant function within your company and put them in charge of the soft design to ensure the design effort does not become fragmented. For change to occur, people must be assigned to the task, empowered to make decisions and held accountable.

For example, to manage massive change, one of our client companies chose its top three people – the best accountant, best actuary and best finance systems person – to form a 'design authority.' Executives empowered the team, which owned the development of the design and for the next five years made sure all

Define the end goal and transition state

Insurers should set an end goal that either focuses on compliance alone or tries to maximise investment by capturing additional benefits. A number of choices will help define the end goal.



Source: PwC ● Current state ● IFRS 17 transition state ● Future state

Be mindful of the following:

- Depending on an insurer's envisioned level of IFRS 17 **reporting capabilities** and **process automation**, there are certain key architectural decisions that need to be considered.
- The decision options presented do not inherently represent good or bad decisions, since it is mostly a matter of **fit for** a particular **context**.
- The decision options presented are not the only alternatives, as intermediate or **hybrid** options can be equally plausible.
- Also, for global insurers, work with your business units to identify and leverage **incremental opportunities** that will help with **future reuse of experience and systems.**

choices and iterations were consistent with the overarching design plan and goals. This governing model was so successful that the company kept the design authority in place even after implementation to serve as the corporate memory and to own future design changes for the finance function.

Assess what ‘good’ looks like and be pragmatic

There is no one-size-fits-all approach. Assess what ‘good’ looks like for your organisation, in the context of how you currently operate. Decide where you need to be ‘best in class’ and where you should make incremental or tactical changes that will keep the organisation flexible going forward. Be pragmatic about the compromises you will need to make.

For example, company executives often say they want to create a ‘best-in-class’ finance function. This sounds like the right kind of goal. But frankly, it’s very hard to achieve. Some companies’ current state is so broken that they have neither the time nor the money to build best in class. For these companies, what ‘good’ looks like is working incrementally to make their finance function better rather than best in class.

Create a road map

Broadly speaking, there are two possible paths to IFRS 17 implementation, and your choice depends on whether your goal is simply to comply or to comply and potentially capture additional benefits. Each approach looks very different in practice. Given the time frame for meeting IFRS 17 regulations, most insurers are focussing on a 'compliance only' approach, in the short to medium term. But a few insurers are choosing a 'maximising investment' approach, which will take longer but deliver more benefits after going live.

Compliance only

With this option, you focus only on the change necessary for compliance. Your goal is to implement IFRS 17 within your existing platforms and systems, with as little investment as possible. You don't pursue strategic changes. For example, if you were to identify a gap in your ability to calculate contractual service margin, you might focus investment on technology to address that weakness and keep your existing ledger and actuarial platforms.

If you choose only to comply, you will be able to leverage previous investments in Solvency II for actuarial calculations of Best Estimate Liability and Risk Adjustment. However, you might need to make investments to comply with the greater level and granularity of disclosure required by IFRS 17.

Maximising investment

Some insurers will spend hundreds of millions of dollars simply to comply with IFRS 17. But if a project is going to cost US$100m, it might make sense to spend another US$10m to maximise benefits. What if, when changing processes, you spend a bit more to add a level of process automation beyond what's necessary to comply? This tool might open up new ways of working and position your company for future automation.

Even with a maximising investment approach, it's possible to keep incremental cost increase low if you time investments to coincide with other changes that generate operational savings. Here are a few ways to maximise your investment in IFRS 17:

- IFRS 17 will significantly change how business performance is reported and measured, creating even greater dependence between finance and actuarial functions. Look at designing a structure that coordinates finance, risk and actuarial data not just to support IFRS 17 requirements but also to provide business insights and analytics across product and business areas.
- You can coordinate planned system upgrades with the development of IFRS 17 requirements. When upgrading actuarial models, consider standardising further and reducing off-model calculations. If yours is one of the many businesses that will need to upgrade its general ledger, think about how to standardise and simplify chart of accounts design. You might also take this chance to harmonise IFRS 17, any local generally accepted accounting principles requirements and Solvency II to meet statutory, regulatory and management reporting needs.
- Evaluate cloud infrastructure and application options. You'll probably need to invest significantly in infrastructure to accommodate massive amounts of data and the need for high processing speeds. Because infrastructure is typically a nonstrategic competency, the cloud may be the best solution to address this requirement.

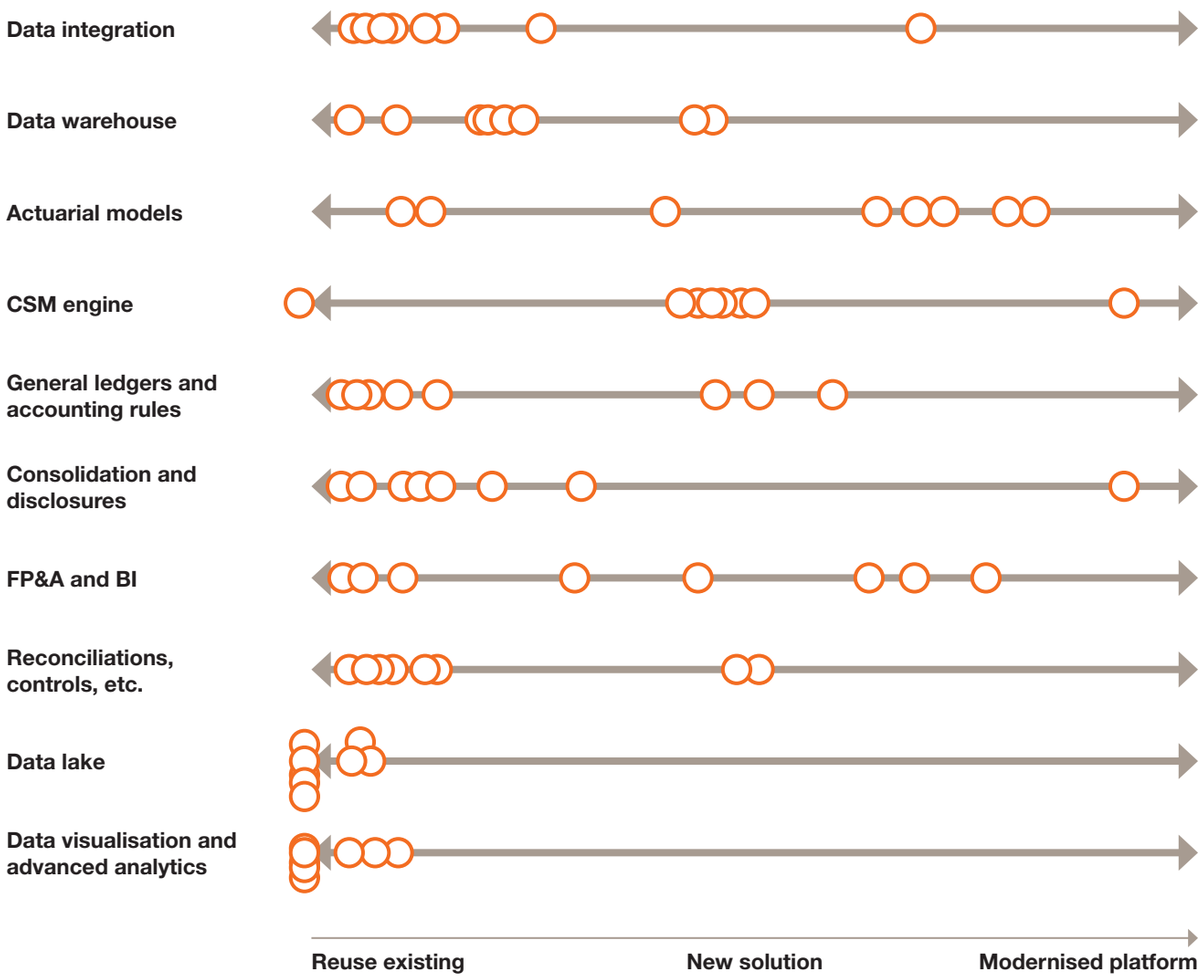
Learn from your peers

There is no one-size-fits-all path to prepare for IFRS 17. In fact, many companies are already implementing different approaches, which might serve as useful examples for you.

For instance, many group insurers assume they will run separate IFRS 17 and Solvency II consolidation and disclosure systems. But in most cases, it would be better to harmonise, particularly if you've implemented a tactical solution for Solvency II. After pursuing a staggered approach, one client found it had accomplished 80 percent of the IFRS 17 requirements but only about 20 percent of Solvency II's. The company then realised it needed to run these in parallel. Other clients are trying to harmonise their chartered accounts across multiple reporting bases. Done right, it will empower them to run a single IFRS 17/Solvency II reporting process and system.

Another example comes from an insurer working to replace its general ledger. Initially it planned to house the general ledger replacement in the IFRS 17 programme but realized that would create delivery risk because general ledger programmes often run longer than expected — especially likely for this company, given the high volume of data it needed to migrate and the complexity of its current business environment. So the company divided the project in two. One project continues to fix the current ledger, handling the simpler tasks to keep the ledger running until it can be replaced. The other project is the ledger replacement programme.

Learn from your peers



Source: PwC

Selected insights

- **Data integration:** Existing technologies are being reused to support IFRS 17. It is unclear which tools will be taken for legacy data and closed and run-off books of business.
- **Data warehouse:** Existing technologies are being reused to support IFRS 17. Several peers are implementing new actuarially focussed solutions to capture assumptions, cash flows, risk adjustment and yield curves.
- **Actuarial models:** Many peers have moved to cloud-based solutions and will leverage these for IFRS 17.
- **CSM:** Market appears to be split between using a finance-based solution (e.g. insurance subledger) vs. an actuarial solution with associated database capabilities. Both may be needed in practice.
- **General ledger (GL):** Many insurers are leveraging existing GL platforms on Day 1, but are mobilising transformational GL programmes in parallel (peers A & G). Others are already on this journey (peer F).
- **Consolidation and disclosures:** Peer G has already implemented an integrated consolidation, FP&A and Tax reporting cloud-based solution and intend to extend this for IFRS 17.
- **Financial planning and analysis (FP&A) and business intelligence (BI):** Peer C and a global brokerage (not shown) have implemented a cloud-based FP&A and BI capability.
- **Reconciliations and controls:** Many peers are reusing existing solutions to support IFRS 17.
- **Data lake:** Peer C has a big data capability in-house and is considering how to leverage this for actuarial and risk purposes. A global North America–based insurer and a domestic South African insurer (not shown as peers) are planning to utilise a data lake capability as part of their finance actuarial and risk landscape.
- **Data visualisation and advanced analytics:** Several insurers have established this capability. It is not presently clear how this will be leveraged for IFRS 17.

In the actuarial space, now is the time to modernise actuarial platforms because insurers cannot continue to run parallel reporting streams for Solvency II and IFRS 17. For example, during implementation of Solvency II five years ago, one of our clients decided wisely to migrate about 30 of its actuarial valuation systems onto a single cloud-based actuarial platform with a data warehouse, automation, integration and workflow. Thanks to that change, its IFRS 17 adaptation will be much simpler than for other insurers.

It's also important to ensure that any new source system leverages data lakes, and that any new accounting or actuarial system can integrate with a data lake to improve flexibility. We are starting to see insurers consider this option more seriously since the alternative – changing data warehouses – is complex. Data warehouse structures can be very rigid, holding highly conformed data sets. Some insurers are concluding that reconstituting their data warehouses for IFRS 17 will probably be more difficult than putting the raw data in a data lake, where it can be used in multiple ways.

No time to lose

In a recent PwC analysis of insurance vendors, we found that most are still developing solutions and are in the process of validating and updating to the final standard. But insurers have no time to lose; they should push forward with field testing (i.e., proof of concept, prototyping and sandboxing) to test different solutions' fit and flexibility.

Don't forget to accelerate your design thinking by taking a soft design approach. Develop working assumptions, take a right-to-left approach to planning, and consider early the wider implications for areas such as management information, tax and financial planning and analysis. In the next three to six months, you should focus on making the key technical accounting decisions in your soft design and engaging vendors in extended proof of concepts and prototypes.

If you engage in these exercises now, alongside the technical interpretation of the standards, you'll be well set to deliver on IFRS 17 requirements.

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