

InsuranceERM

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A photograph showing two hikers silhouetted against a bright, orange sunset sky. One hiker is standing on a rocky ridge, reaching out with a stick to assist the other hiker, who is climbing up. The scene is dramatic and inspiring, symbolizing overcoming challenges.

IFRS 17 – another big step for risk and actuarial

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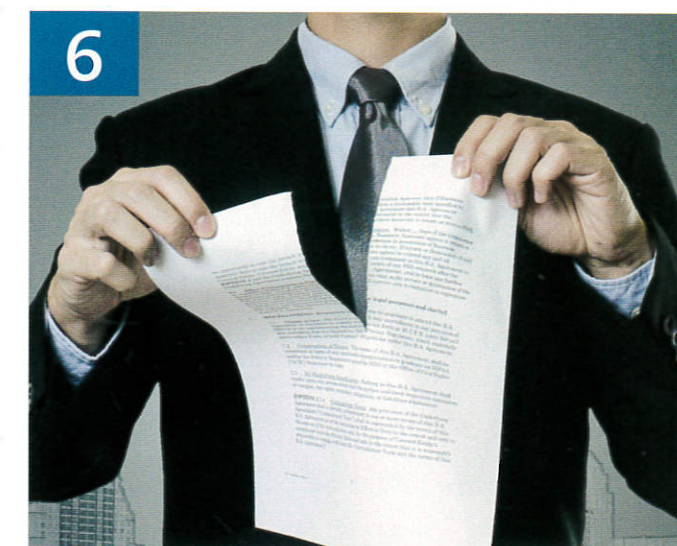
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Enable Financial Insight, Control and Transparency



Aptitude Software delivers specialist finance applications to equip Insurance CFO's to fulfil their strategies and ambitions.

Our software controls and automates insurance accounting processes so that CFO's can deliver faster, relevant and integrated financial reporting; underpin decision-making with aligned finance, risk and actuarial data foundations; and achieve compliance with regulatory requirements efficiently.

"I've listened to a number of IFRS 17 vendor presentations, and Aptitude has the best. When the others present, they say they're going to have great data and they're going to have great controls... It's these financial and accounting complexities that Aptitude has considered that differentiates the company from the rest."

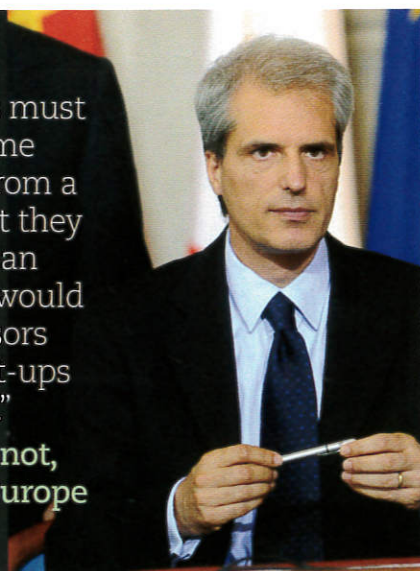
– Big 4 Advisory Partner

Schedule a briefing of Aptitude IFRS 17 and Insurance Accounting solutions
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Quotes of the quarter

"Consumers must have the same protection from a start-up that they would from an insurer. We would ask supervisors to treat start-ups consistently."

Sergio Balbinot,
Insurance Europe



"Solvency II is obscuring the transition from IFRS earnings, to cash and on to dividends. This risks driving up the sector's cost of equity, particularly if markets dislocate and concerns emerge about the capital security."

Kamran Foroughi,
Willis Towers Watson



"Before we received the [Solvency II annual] reporting we had no real sense of what level of discrepancies we would find, but we are finding enough certainly to keep us busy."

Allan Kearns, Central
Bank of Ireland



"While scrapping Dodd-Frank altogether is less talked about there clearly is a desire for significant reform."

Leigh Ann Pusey,
American
Insurance
Association



"I have a quiet optimism that Brexit might create some regulatory competition as the UK has to figure out its trade agreements and how it is going to behave and compete with the continent."

Mike Sapnar, Transatlantic
Reinsurance



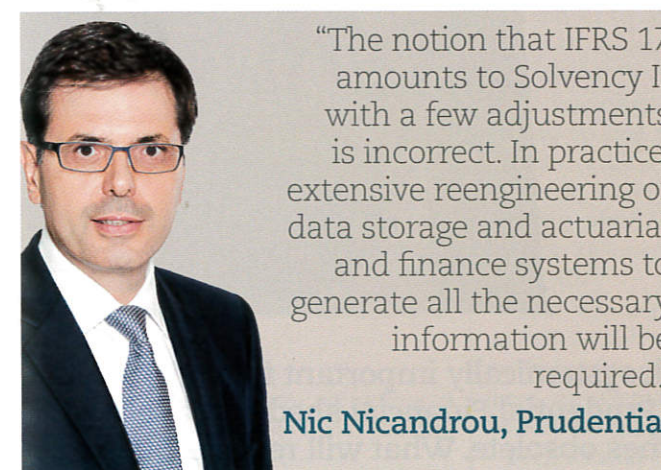
"While data breaches and cyber related attacks have become more prevalent for individual businesses, concern about systemic cyber-attacks are on the minds of those in the very community dedicated to analysing and preventing this threat."

Tracie Grella, AIG
(published two days
before WannaCry
ransomware attack)



"The notion that IFRS 17 amounts to Solvency II with a few adjustments is incorrect. In practice, extensive reengineering of data storage and actuarial and finance systems to generate all the necessary information will be required."

Nic Nicandrou, Prudential



"We will maintain the entities approach [to identifying systemic risk], develop an activities-based approach, and they will co-exist."

Yoshihiro Kawai, International Association of
Insurance Supervisors

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"The temptation for the regulator must be to see the CRO as a policeman, effectively the regulator's eyes and ears within a company. I think that would be very unhealthy for the role."

Stephen Wilcox,
Allianz



"[Solvency and financial condition reports] do not allow us to compare the relative capital or reserve strength of insurance companies. SFCRs are simply not fit for their purpose."

Thomas Seidl, Bernstein



IFRS 17 compliance: a task comparable with Solvency II?

IFRS 17 has been described as a landmark shift in insurer accounting and some are saying that implementation could require more work than was needed for Solvency II. *InsuranceERM* gets the lowdown from the industry on what it means for the sector

The International Accounting Standards Board (IASB) published the IFRS 17 standard on accounting for insurance contracts on 18 May, giving underwriters around three and a half years to deal with a revolution in accounting practices.

"This standard represents the most significant change to insurance accounting requirements in 20 years," says Martin Bradley, risk and actuarial leader at consultancy EY.

IFRS 17 aims to provide a single standard for accounting that will be useful to investors and insurers alike. It replaces the IFRS 4 standard that allowed a "myriad of accounting practices", according to IASB chairman Hans Hoogervorst.

But the industry is fearful of the cost required to implement the new standard and some are comparing the challenge to that presented by Solvency II. The IASB has not attempted to quantify the cost, but asserts that the benefits of the transition, in terms of improved reporting, are expected to outweigh the expenditure.

InsuranceERM has prepared this Q&A to explain the changes ahead.

Who will be affected?

More than 120 countries use IFRS standards and insurers in Asia and Europe will be most impacted. This includes large listed insurers, which must report under IFRS, as well as many more that do so voluntarily.

According to IASB analysis, it will affect at least 449 listed insurers with \$13.3trn of assets, and a further 46 unlisted insurers.

The scope also extends to other financial services, such as banks with equity release contracts.

The IASB is not a regulator, so it's up to each country to endorse the approach. The changes may also filter down into local generally agreed accounting principles (GAAP) standards.

The big exception is the US, which will remain under US GAAP accounting.

So what exactly will change?

IFRS 17 will change the measure of profit and equity in insurers' accounts, and change how the accounts are presented.

Profits will be earned as insurers serve the customer, rather than the current practice of earning profits as the product is sold.

This means that insurers will need to calculate carefully how cash-flows emerge from contracts over their lifetime and, at the point of sale, measure the expected profits in the so-called contractual service margin (CSM).

The profit calculated at the point of sale will be adjusted on a regular basis to account for updated assumptions on risks, interest rates, etc.

"The accounting around the CSM is perhaps the most important element of IFRS 17," explains Francesco Nagari, global IFRS insurance leader at Deloitte.

Will some insurers be affected more than others?

Life insurers are going to find the transition harder than non-life firms, because contracts

of one year or shorter can use a simplified approach. Any business longer than a year has to calculate the CSM.

"The long duration contracts - life insurance, annuities, other forms say disability insurance, compensation type of insurance, long term type of liabilities - are going to be much more affected, because of the current measurement you have to apply at each valuation date and the processes you need to go to will be different than what's typically done today," says William Hines, consulting actuary at Milliman.

The degree of impact will also depend on where firms are starting from. The standard can be considered a hybrid between book-value accounting, common in continental Europe and Asia, and the more forward-looking accounting measure used in the UK and other jurisdictions, according to Kamran Foroughi, a director at consultancy Willis Towers Watson. "This

sort of model is fairly untested globally, but it's not that different from the model that operates in Australia."

What are the biggest challenges facing insurers?

First, IFRS 17 is principles-based, so insurers will have to interpret and make judgements on the rules.

But many expect the biggest challenges to be around systems and processes to deal with the new calculations, which require a much more detailed level of information on contracts, and will need updated frequently as assumptions change.

"There is going to be a lot of work around systems, data and processes, particularly in order to track the CSM," explains Simon Perry, principal, IFRS 17 lead at accounting firm Grant Thornton.

Insurers with business written over a number of years will need to go back and figure out the CSM when the contracts were first written. "Companies potentially won't have the systems to do that," he notes.

Martin Sarjeant, global risk solutions leader at software vendor FIS says that IFRS 17 "brings insurers' actuarial models and calculations into the heart of their financial reporting function" and means teams will have to collaborate more effectively, and ensure actuarial systems are well governed and connect with finance systems.

"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. 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," Sarjeant says.

Finally, there are stakeholder expectations to manage. The change in profits and equity compared with existing regimes will need explaining, as will the comparison to other metrics such as Solvency II and embedded value.

Some are expecting IFRS 17 to result in more volatile results for

Martin Sarjeant: actuarial calculations for IFRS 17 will now effectively drive a company's profits



Hans Hoogervorst, IASB: IFRS4 allowed myriad of accounting practices

insurers, and the new standard may also affect the ability of companies to pay dividends, and even impact on executive bonuses.

"Whilst ultimate profits will not change, the emergence of those profits can change significantly. Both insurers and their analysts will need to assess the full impact in terms of telling the performance story of their companies," says Alex Bertolotti, global IFRS insurance leader at PwC.

Will it be as big a challenge as Solvency II?

For some firms it won't be, for others it may be worse. The scope of IFRS 17 is certainly narrower than Solvency II, but the practical challenges of delivering the correct numbers on time are similar.

"Talking to clients, you hear a whole range of estimates as to what this might cost, which is anywhere between 25% of Solvency II to 200% of Solvency II. It's a big range and it will depend on each company. The general view is, it's not going to be small," says Perry at Grant Thornton.

According to European Commission estimates, the cost of implementing Solvency II in the EU was €3bn-4bn (\$3.4-4.5bn).

"I think IFRS 17 implementations will take a similar amount of effort to Solvency II, says Sarjeant at FIS. "However, the standard is likely to affect different areas and focus spending more on governance and the streamlining of reporting than on modelling."



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Firms that have already implemented Solvency II should be in a better position than most, because their governance will be up to scratch and they will be able to re-use work on modelling.

Foroughi at WTW notes the huge impact that Solvency II had on certain markets and posed challenges for insurers on how they managed their business in the post-Solvency II world.

"There may well be similar effects on markets and products, and questions about managing the business in [the] post-IFRS world, so on that level it's a similar challenge," he says.

How long does the industry have to prepare?

IFRS 17 is to be implemented on 1 January 2021, giving firms three-and-a-half years from now – probably the longest period ever given to prepare for a new IFRS standard.

Insurers will need to produce IFRS 17 accounts for the 2020 year-end to give themselves a prior-year comparison come 2021.

"Unlike with Solvency II, there are no impact studies to complete or regulators creating interim deadlines. So it's up to insurers to come up with realistic plans," says WTW's Kamran Foroughi.

Is the industry well prepared?

Some firms have been very engaged and worked on estimates of the financial and operational impacts, while other have done little if anything so far.

Henny Verheugen, principal and consulting actuary at Milliman, says the consulting firm recently surveyed 100 insurers worldwide, and about 70% were following developments and doing some early-stage interpretation "but haven't done much more than that. The other 30% are in the process of doing gap analysis, all sorts of field testing, and doing some test runs."

"Levels of preparedness can certainly vary between regions and according to their levels of financial and actuarial governance. The size of company and whether it is a life or non-life insurer can also make a difference," says FIS's Sarjeant.

Observers have noted a reluctance to



"The IASB has been transparent in the development of the standard, and every decision has been discussed publicly"
Francesco Nagari,
Deloitte

spend money on IFRS 17 until insurers knew it was definitely happening – a view that may change now.

Though 2021 seems a long way off, Perry at Grant Thornton says the preparation work is going to be demanding. "The time is going quickly. Those companies that haven't done anything yet are probably going to find out they have a lot of work to do over the coming months and years," he says.

Does the publication of the final text contain any surprises?

The final text was considerably different from the previous exposure draft, but the changes have been openly discussed at IASB meetings and though the industry would have liked to have viewed the final text ahead of publication, anyone closely following the progress is unlikely to be shocked.

Deloitte's Nagari says in his initial reading of the standard on 18 May: "We have not found anything different to what we were expecting. The IASB has been transparent in the development of the standard, and every decision has been discussed publicly. We haven't seen anything surprising today."

Will there be any more amendments to IFRS 17?

Full implementation may reveal difficulties and impracticalities for insurers, and the IASB could be open to quite significant changes in the run up to 2021. The board is establishing a Transition Resource Group (TRG) to support implementation and the TRG can force a change in wording, if the industry successfully argues its case.

In the past such TRGs have wielded considerable power: in the case of IFRS 9, the corresponding group won a one-year delay to the implementation date and a major change to the standard.

How long has it taken to develop IFRS 17?

Practically 20 years. The official kick-off was the publication of the first draft statement of principles in 2001, but the first discussions on the standard began in 1997.

A discussion paper was published in 2007, followed by the first and second exposure drafts in 2010 and 2013 respectively.

What about IFRS 9?

Insurers have won special dispensation to implement IFRS 9, the accounting standard covering financial instruments, at the same time as IFRS 17 (i.e. 1 January 2021), whereas the rest of commerce has a deadline of 1 January 2018.

Nonetheless, IFRS 9 may bring more unwanted volatility in reported profit. ■

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High velocity risk management

A rapidly changing world produces rapidly emerging risks that can flummox even the most comprehensive of risk management frameworks. Neil Cante proposes an approach to improving how insurers respond to today's threats and opportunities

Modern business is already complex and challenging but, as digitalisation progresses, it is also getting a lot faster and even more inter-connected. This presents a significant challenge for risk managers as most risk frameworks are simply not geared up for risks appearing at high velocity or in a very non-linear way.

Financial markets can move quickly and sometimes unpredictably, so financial risk monitoring is often an element of the framework which is able to identify rapid movement. But other areas like operational and strategic risk still tend to rely on relatively slow-moving frameworks involving components such as registers and escalation processes.

So, how do you manage risks which can flash out of nowhere? The answer is, essentially, that you have to get skilled at anticipating them and maintain operational resilience to give you the flexibility to react if they occur.

This requires a consistent self-challenge by looking at emerging trends which could lead to particular outcomes and asking, "Would we see that coming?" If the answer is "no" or "maybe" then improvements can be made to the risk management framework, or actions taken to remove yourself from its path.

Common mistake

A common mistake with emerging risk processes is that they start with a trend and ask, "What could this do to us?" The problem with this is that the answer is often, "It depends!"

It is almost never the case that a particular trend will evolve in isolation. Rather, it will co-evolve with a number of other trends, each influencing the others, to produce an emergent final outcome which you cannot know by looking at each trend in isolation.



Neil Cante

You must therefore decide which outcomes you are interested in first and develop narratives, themed with the trends you are trying to understand, which plausibly take you from today to those outcomes.

So, for example, if you are concerned about whether consumers will continue to purchase long-term savings policies and you have identified emerging trends involving the adoption of new technologies and changing social behaviours, then you should develop scenarios which explore how those trends might influence attitudes to long-term saving and where the tipping points are.

For each scenario, your challenge is to consider whether the identified features would be appropriately identified by the risk framework and whether the required actions to mitigate the risk would be flagged. The new trend might involve a combination of factors which, individually, appear rather benign but their combined effect is highly unfavourable. Risk frameworks which look at indicators individually would miss this.

Adaptive Monitoring

In addition to building narratives based on input from subject matter experts, it is increasingly possible to build adaptive monitoring tools which can identify new

trends from data and reveal complex relationships which are otherwise hard to spot.

This involves capturing information about items which are potentially related to the outcomes you are interested in and whether the relationships present are consistent with your theories.

Increasingly, this information need not be structured or numerical. Visualisation techniques can help to present large complex information sets in a way that makes it easier for experts to spot patterns. And, non-linear relationship measures, such as entropy, can be used to determine networks of relationships which can then be evaluated to help experts describe their meaning.

A further recent advance is the ability to deploy artificial intelligence (such as deep neural networks) to elicit trends from text, even if you don't really know what you're looking for, and identify emerging trends, insights about the communication network structure and the strength of feeling about the topics.

Helping your experts to describe compelling narratives about the future and testing the organisation's ability to prosper under those circumstances provides a robust ongoing process which enables the organisation to constantly test its ability to see and manage new events.

As robotisation increasingly frees the risk management team up from traditional oversight tasks, they can reorient themselves towards more of an "insight" role, providing regular information to the business about what is going on and how to recognise the onset of new trends. This helps the business to anticipate and prepare for an uncertain, high velocity, environment and remain agile.

Neil Cante is principal and consulting actuary at Milliman in London

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The future of the finance function

Under the weight of regulatory demands, insurers' finance functions have struggled to deliver the insight that the business needs – and that they wish to produce. In this *InsuranceERM* / Aptitude Software roundtable, chief financial officers and controllers discuss the expanding role of the finance team and how technology can help reach their goals



Left to right: James Cooper, financial controller, Lockton; Ila Naieri, finance specialist, Aptitude Software; Chris O'Brien, CFO, Travelers Lloyd's Syndicate 5000; Anna Miskin, CFO, VitalityHealth UK; Christopher Cundy, managing editor, *InsuranceERM* and *Insurance Asset Risk*; Colin Charles, independent consultant to CFOs; Ross Chapman, marketing director, Aptitude Software

Chris Cundy: What are the main challenges facing finance functions?

Ross Chapman: I see a bit of a perfect storm. CFOs and their teams have run out of time. The finance function in many large enterprises is having a hard time serving all the backwards-looking statutory reporting requirements and doesn't find it easy to deliver forward-looking advice to the business.

Colin Charles: I know we have just climbed the mountain of Solvency II pillar 3 reporting, but I have seen so many businesses just looking backwards now, and it cannot be right.

My hope is that with all the pain that people have gone through with pillar 3, we can make use of the data in there. If you have good data analytics, then potentially finance can come out of this with lots of helpful information.

Anna Miskin: Management are craving insight, but regular reporting tasks take priority. Sometimes we don't have capacity or skill to interpret data and make good sense of it for management. The hope is that in the years to come, we will be able to almost fully outsource the mundane reporting duties to machines, and focus on transforming data into the forward-looking, decision-relevant information, but of course this is a big task.

Chris O'Brien: I suspect a lot of that data exists within the finance world and we are not sharing it.

Anna Miskin: ... or sharing with actuarial or pricing, and these functions are working in silos.

Chris O'Brien: That is why we have to break down silos and take the data and insights



we have to the CEO. We have to say, 'Hey, look, did you know this about what we have here?', because people appear to think, 'finance or the actuaries will get on with that and then we will do something better afterwards.'

James Cooper: There have been a lot of events this past year that have put the finance function under pressure. We have had to deal with Brexit, such as managing the currency fluctuations and putting in place hedges; we have had to deal with visits from the regulator because they have become more interested in having client money controls. At the same time, the business has an expectation about how finance can embrace technology and provide insight.

A BIGGER CONTRIBUTION

Chris Cundy: What would you be like to be doing more of?

Chris O'Brien: The real job satisfaction comes from contributing to the business. When we are stuck for large parts of the year filling in backward-looking returns, we do not have the time to do that forward-looking value-adding consulting. For many of my stakeholders, they thought the year-end was done by January and it was not!

Anna Miskin: If I had more time, I would

"Management are craving insight, but regular reporting tasks take priority. Sometimes we don't have capacity or skill to interpret data and make good sense of it for management"

Anna Miskin, VitalityHealth UK

spend it on forward-looking, what-if type analysis for the company at large. For example, the focus of product development in the actuarial function is on the profitability and value generation of the product itself. However, I also want to know what it is likely to do to my business mix, acquisition costs, liquidity, capital, competitive position and so on. Joining up information and knowledge from finance, pricing, actuarial capital management and risk would be a very good thing. Then we could get quick answers to simple commercial questions such as, 'So, what do you think I should pay to acquire this business?'

James Cooper: We have been asked quite often this year to help with M&A. The business wants the finance view, but it is complex to understand a business, and

what costs and revenue synergies there might be on integration.

It's incredibly time consuming, but on the positive side you work very closely with the business and deepen the relationship, which is part of how you move forwards with finance as a business partner.

Colin Charles: There is a danger that you are asked to do things and you cannot do it as well as you would like to because the regulatory returns have to be the number one priority. So you stop being asked. Finance professionals need to push those doors back open again and say, 'Yes, we can do this.'

Ross Chapman: This is why we're passionate about finance. I always view the CFO as having the keys to the kingdom. Many industries such as insurance, telecoms, banking and healthcare have become characterised by high volumes of business, with multi-national operations, serving customers with complex contracts, and finance is the only function within the business that can be a strategic advisor to the business, using its data to unlock value.

IDEAL CHARACTERISTICS

Chris Cundy: What characteristics should the finance function possess if it is going to be a business partner?

Chris O'Brien: You have to think like the

"This is why we're passionate about finance. I always view the CFO as having the keys to the kingdom"

Ross Chapman, Aptitude Software

business; you have to understand what they do, why they do it, but maintain your distance and not 'go native'. Be close to them, sit with them sometimes, go to their meetings and really learn what drives them and what they are interested in and connect that to what, as a finance person, we are seeing and what skills we can offer to them to solve the problems they have.

Anna Miskin: We have people almost 'seconded' to the business as finance business partners. They do not just go to some meetings, they are pretty much immersed in their partnering business area. There's always a bit of a risk that they go too 'native' and lose the ability to challenge, which I consider a significant part of a business partner's role. However, I am getting really good feedback from the business and believe that this is a genuine win-win partnership. We are business partnering with IT, services & operations and marketing, which are the biggest cost consumers in our business.

One thing I learned - you have to dedicate these people. Business partnering cannot be something like a contact centre, where a business comes and asks for help and whoever is available picks it up.

Colin Charles: I totally agree: it has to be a formal structure. And it is an expensive way of doing things, but it is the only way that you are really going to get under the skin and demonstrate the value of the finance team.

James Cooper: We have an entrepreneurial culture at Lockton and we see the business partners as being an important analytical resource for good decision-making. There is a lot of empowerment at various levels throughout the organisation, so it is about making sure that there is some consistency in the way decisions are taken that is aligned with our strategy.



Chris Cundy: Does it happen the other way around at all, where people are seconded into the finance function?

Anna Miskin: I wish it were happening more often because, for example, in my organisation finance is very data driven and reliant on actuarial support. I could do with more data analytics, actuarial and clinical risk resources seconded in.

Chris O'Brien: It is not something in my experience but I can see benefits of doing it. I can see it being difficult, though, because we need certain skills in the department. But more crossover can only be good.

Ross Chapman: Are things like IFRS 17 and Solvency II driving the actuarial function and finance closer together, and improving the ability to better understand and serve the business with linked-up data tied to business performance?

Chris O'Brien: I think so. We have always had a good relationship with the actuaries because we are interdependent, we share data, we input and peer review each other's work, but I think Solvency II has made that essential.

Anna Miskin: In my team, anything which is related to actuarial reporting and capital is within my remit. So I manage a team of actuaries alongside a team of accountants; that is probably because I am not just an accountant, I am also an actuary. This has proved to be a good partnership because pretty much every management decision

which has financial consequences has a capital impact as well, so you cannot manage them separately.

PRODUCT DEVELOPMENT

Chris Cundy: How do you get involved with product development? Will someone come to you and say, 'We have this great idea,' or will the finance team generate ideas?

Chris O'Brien: I would like to think it was the latter, but in my own experience it is more the former. People come to us and say there is an opportunity and we would work with actuaries, capital modellers, we would model what the opportunity could look like into the future, what its capital requirements would be, how it would sit in our reinsurance programme, what the costs of acquiring the individuals to do that business would be, the acquisition costs and so on.

Colin Charles: The only time that changes is when a business has a pool of cash looking to make acquisitions or organic development. A finance function can have its own M&A or research centre, whatever you call it, and be proactive. Generally, 'we had better ask finance to see what they think' is third or fourth down the list, whereas it can be a prime driver.

James Cooper: With the very soft market across virtually all lines, it may explain why there is more pressure now on finance's

work. More people want to understand what is going on in their business and how they can lift their margin.

Chris O'Brien: And it is not just about adding product; it could be about withdrawing from product, or scaling back because conditions are very tough in some areas.

GRANULAR INFORMATION

Chris Cundy: Do you crave more granular information? Or maybe you have the information you need, and it is just a question of organising it?

Colin Charles: More granular analysis of the technical account can only be a good thing. So, if you can get data by territory or by whatever attribute you have and you can cut and dice it on that basis to derive a loss ratio, you can achieve some valuable insight. I am not at all a believer in allocating fixed/indirect cost; it does not particularly help the equation, all you do is get the underwriters fighting over who should get which cost allocated where.

Chris O'Brien: If it is reliable data, I do

not think it can ever be a bad thing. What we have to be careful of is that we use it appropriately. Sometimes granular data will be good to answer one particular question, but for other questions you may not need it.

Anna Miskin: The danger with granularity is that a uniform approach to analysis of all granular blocks of data (eg an intersection of market, channel, product, underwriting types etc) makes the process time-consuming and not efficient. In the monthly performance packs, you have to be smart to not report pages and pages of analysis at the same level of detail, month-on-month, but zoom into the areas that are of genuine importance to substantial depth - and these areas may change every month.

FINANCIAL ANALYSIS CHANGING

Chris Cundy: How is your delivery of financial analysis changing? Have you got mobile and iPad apps that your executives can use to view the business and drill down into data?

Colin Charles: The only app-based data I

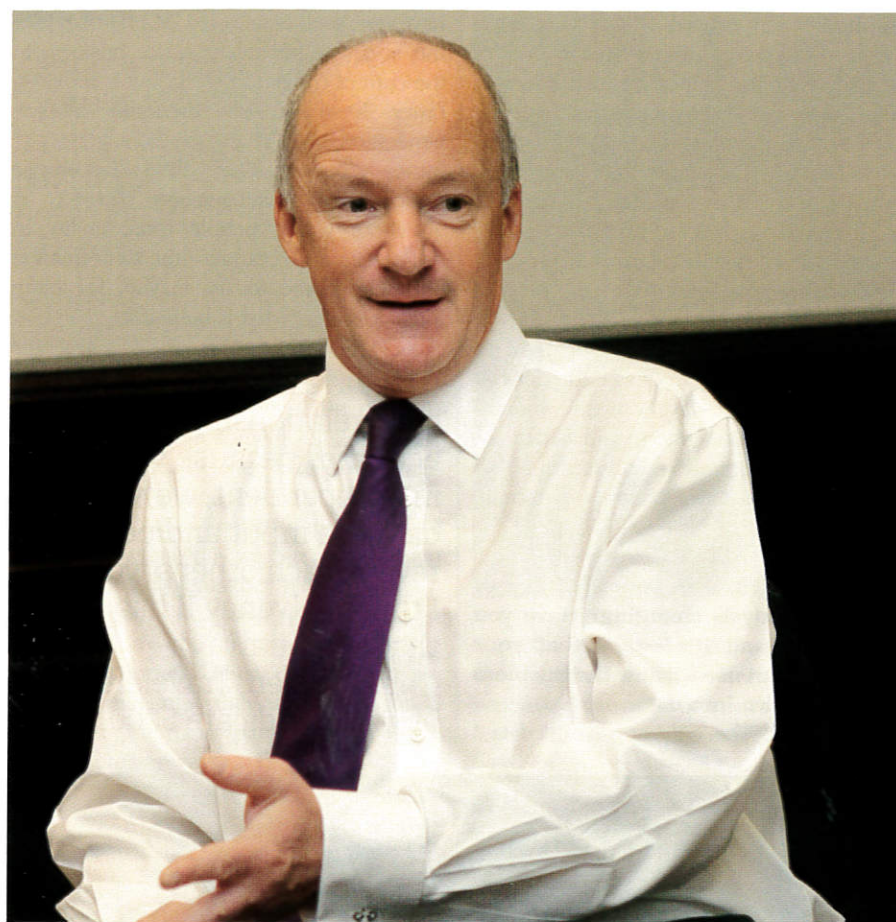
have ever seen is sales-led. Maybe that's not the best way for an insurance business in the current climate to work, but it provides faster feedback on premium income generation.

James Cooper: Our EPM [enterprise performance management] project is all about giving people more ability to self-serve and extract the information and then come to us, maybe, for more intelligence on what is behind it.

"We have always had a good relationship with the actuaries because we are interdependent, we share data, we input and peer review each other's work, but I think Solvency II has made that essential"

Chris O'Brien, Travelers Lloyd's Syndicate 5000





"I am not at all a believer in allocating fixed/indirect cost; it does not particularly help the equation, all you do is get the underwriters fighting over who should get which cost allocated where"

Colin Charles, independent consultant

this number is right. You might not like it, it might not make sense, but it is right, and we cannot lose that ability; the business needs it.

ARTIFICIAL INTELLIGENCE

Chris Cundy: Have any of you investigated what AI might help you do?

James Cooper: Not many AI systems yet are at the level where they are going to add value, but you can see within a generation that will be a different story. Look at the way it is already catching on in the investment management world: AI systems help them make better decisions on when to enter and exit markets and things like that.

Chris Cundy: Are there any particular aspects of the finance function where AI could make a real big impact?

James Cooper: One is the analytics. When you have enough data, it can help you identify what products are profitable and where you should concentrate your efforts as a business, and can eventually help you formulate strategies. It will identify things that you did not know about your business, like why is a particular team so successful? It will start showing out in numbers you have not currently got anyone looking at.

Anna Miskin: It will certainly help us to get rid of reporting – or make it occupy just 10% of our time – and help us to concentrate on the value-added tasks. However, there will be a long period when we will still have to be extremely clever and quick in interpreting what the machine is telling us, because all the machine will be doing is finding correlations between masses of different parameters, and we may end up with very spurious correlations.

James Cooper: A number of insurers are

Literally every COO and every business lead and some of their key people beneath them will have access to financial information. A lot of the regular requests, which can sometimes inundate finance and distract you from doing more interesting analysis, should go away with an EPM system which allows the business to access financial information more directly, thereby freeing up finance to add more value.

STAFF CHANGES

Chris Cundy: Looking forward five years, do you think you will have the same number of staff, more or fewer, and what might be the drivers for that change?

Colin Charles: The ideal would be the same number, but doing more value-added work.

Chris Cundy: Is the driver for that the automation of the more mundane work?

Colin Charles: Yes. In those surveys of AI [artificial intelligence] accountants are one

of the more likely groups to be replaced by AI, and you can see why. Having said that, we have been trying to do accounts payable on an automated basis for 20 years, too, and that is still manual!

Anna Miskin: I certainly dream of a world where the word 'reconciliation' disappears from the vocabulary.

Chris O'Brien: There is a risk sometimes with automation that you lose the understanding. It becomes a black box and it says, 'The answer is this.' If someone challenges that, you may not know what has gone on. We have to embrace automation, but we need to make sure we do not lose the ability to provide the basic essential check at the end: does that look right?

James Cooper: Accounting is about judgement, after all.

Chris O'Brien: An essential function of the finance team is to provide 'quality assurance' and for us to be able to stand in front of our stakeholders and say, 'Actually

starting big data projects, using algorithms to try and find relationships, and the data they collect for that will become even more valuable when AI is developed. Good quality data over a long period of time is what you need.

Colin Charles: Thanks to all the regulation, we are producing financial data more accurately than ever. But it is then the ancillary data – what does not end up in PeopleSoft or your general ledger – that can suddenly become a key decision factor in this AI world, and there's a big risk that it was entered wrongly in the first place.

Anna Miskin: Also consider the continuity and consistency of accumulation of this data across time. We are making changes in the way we sell, price or target our customers in response to market moves. This will confuse correlations unless there is a precise mapping of old into new.

NEW SKILLSETS

Chris Cundy: Are there any particular skillsets that you think you will need more of, in the near term?

Colin Charles: I would like to see more accountants who can translate financial

data into 'business speak' and develop good relationships with others in the business – particularly underwriters and sales/marketing.

Anna Miskin: My first priority is communication and presentation skills; second is probably data.

Chris O'Brien: You need the ability to mine the data, and slice and dice it, but you also need that accounting discipline of control: making sure you are comfortable with the data.

James Cooper: There is an underlying core acumen of financial understanding, accounting knowledge, etc. but more valuable is becoming the stuff which is not necessarily a traditional trait or learned as part of your qualification, i.e. people skills, relationship building and the ability to influence.

Colin Charles: That is not to say that everyone needs to be like that – there is definitely space for the tax specialist or whatever it might be. However, I think that the inward-looking accountant seems to have become more important over the last few years, whereas I'd like to see more outward, forward-looking individuals, still

with the rigour of an accounting training, getting the upper hand.

LONG-TERM STRATEGY

Chris Cundy: How can finance help develop long-term value-generating strategies?

Chris O'Brien: Finance is good at pulling things together from different sources, distilling it and presenting it coherently. In the question you have the word 'help', and we have to recognise we are part of a bigger team and we should never try to do too much of this on our own.

But we can define what added-value would be, how we measure success, and then create a coherent and logical programme of how you would get there.

James Cooper: How do we know we are delivering on strategy? How do we monitor we are on track? Those KPIs are something that finance can calculate and forecast on, and outline to the business what actions may help in reaching strategic goals.

Chris O'Brien: You always have to challenge strategy as well. There are different people within the business who will want to serve different stakeholders, so you have to play devil's advocate, in terms of making sure we have considered a whole community of stakeholders and not just the sales manager's or the CEO's preferred one.

REGULATORY HEADACHES

Chris Cundy: Which regulations are causing you the biggest headache?

James Cooper: Brexit is one of the biggest changes over the next few years and there are a lot of unknowns. You need to work on contingency plans and look at different scenarios and what possible impacts that it might have.

Chris O'Brien: It is a problem we would prefer not to have. It will not be easy, but it can be dealt with as more of an operational, rather than strategic, issue.

Anna Miskin: Solvency II is still a bit of a pain, in the sense of how do we create value out of it. As for IFRS 17, let us see what that brings. The third one is probably GDPR [the General Data Protection Regulation]. Finance is not the biggest part of it, but it is a big European-wide project that will undoubtedly impact the way we accumulate and process information. ■



IFRS 17: What the industry thinks about implementation



The IFRS 17 accounting standard for insurance contracts is due to take effect in 2021, but some insurers are already complaining about the complexity it brings, and querying whether the benefit will outweigh the effort and investment in the project.

The potential headaches that IFRS 17 will cause were discussed at InsuranceERM's Data for ERM & Solvency II conference on 7 June. Ross Chapman, marketing director of software vendor Aptitude, asked a panel comprising life and general insurers, actuarial and accounting experts, to share their insights into the implementation challenges.

Jo Clube, group technical accounting director, Aviva

What is different about IFRS 17?

IFRS 17 is going to fundamentally change how we measure and report our insurance contracts. The basic measurement model has the same building blocks as Solvency II, but overlays a performance mechanism to measure profit – that's where

the complexity comes in.

The first big difference is the scope of IFRS 17: it's just your insurance contracts and participating investment contracts. Unit-linked products, where there's no insurance risk, will not be measured under IFRS 17.

IFRS 17 is much more principles-based. The standard says you should reflect the characteristics of the liability. There are no details, guidance or anything prescriptive about what the discount rate should be, so there could be a big difference with Solvency II numbers. Similarly with

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the risk adjustment.

Another difference is the contractual service margin – the profit that you expect to earn over the lifetime of a contract. That future profit, which you haven't earned yet, goes on your balance sheet as a liability, and then you earn over time as you deliver the service or the contract. There is a lot of complexity in that.

The great hope is that it will bring consistency to insurance reporting. But actually there are quite a lot of choices within the standard, such as around the discount rate and which variation of the model you use.

How will IFRS 17 affect tax?

In terms of tax, I think the UK is quite unique, as we use IFRS profits as the basis for tax, with no adjustments. So it's going to directly impact how much tax you pay.

For example, annuity contracts are currently recognising a lot of profit on day one. Those profits will have been taxed. In the IFRS 17 transition, we're going to have to reverse those profits and put them back on the balance sheet, then they will be recognised again in line with the IFRS 17 principles. We need to figure out with tax authorities how we deal with that transition, to make sure profits don't get taxed twice, or that profits on other profits don't escape tax.

Prashanth Ariyam

Prashanth Ariyam, UK IFRS 17 audit lead, Deloitte

What's going to be the impact on profitability?

The impact on the income statement will be entity-specific and depend on a number of factors. Typically, the longer the duration of the product, the greater the impact.

If you are a life insurer and have annuity-type contracts, typically under the current IFRS you recognise big day-one profits. Some CFOs have said to me they recognise 80% of profits on day one. Under the IFRS 17, much of that profit will be deferred over the term of that policy, which could be 10, 15, 20 years.

For a with-profits contract, the impact could be the opposite. Under current IFRS, typically you recognise small profits over the life of the contract, with a big component at the end. Under IFRS 17, you accelerate that recognition for accounting purposes.

For general insurance, where typically the coverage is a 12-month policy, there is probably not a huge amount of difference. But in the 'expired portion', the claims reserve, we see some difference in profits: that's largely due to the choice around the discounting, the risk adjustment and some other technicalities.

Richard Olswang, head of finance actuarial, Prudential

What makes IFRS 17 so complex?

Probably the two biggest areas of complexity are the unit of account and transition.

The unit of account is the level at which you can aggregate contracts. IFRS 17 is an individual contract standard, but it allows a degree of grouping. That grouping is very important, because profits are spread over the course of a contract, but if the contract is loss-making (onerous) then the loss is recognised on day one. If you group these together, you get a very different profit profile from accounting for them separately.

The level of aggregation is also

Richard Olswang



critical from an operational perspective, as it will have a big impact on systems and processes.

The other area is transition. When you first implement IFRS 17, you must have an opening balance sheet and the objective is to determine that as if it you had always applied that standard – effectively going back to when the business was written, calculating the contractual service margin and the day one profit at that time, and rolling it forward.

It's clearly difficult to do. There are alternatives, but that is a big area of complexity and will have a huge impact on the results. On day one of IFRS 17, all of the shareholder equity and profit will be driven by the transition balance sheet.

Looking at the solution architecture, is IFRS 17 just Solvency II with a CSM engine top of it?

It is a lot more than that. You can leverage a lot from the Solvency II investment, but there is more required on top. Start with the actuarial models that calculate the basic liabilities: you'll be able to use those, but IFRS 17 will inevitably use different assumptions and will require more granular output and it will require multiple runs. So, the models will need to be adapted and enhanced to be able to give all that output and do all those runs in a very short reporting timeframe.

There will need to be a process to leverage from the Solvency II risk margin to an IFRS 17 risk adjustment. The contractual service margin is new; that will require a

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completely new system to calculate it and data storage systems. Then there will be changes to general ledgers and financial consolidation systems.

What stage is the industry at in terms of preparations?

IFRS 17 has to be implemented by 1 January 2021. It sounds like a long way off, but you're going to have to start designing those systems fairly soon. But you can't do that until you decide on your accounting policy. That might not be a final accounting policy, but you need working assumptions to be able to specify the system changes.

Thomas Behar, chief actuary, CNP Assurances

What from the Solvency II implementation will be applicable to IFRS 17?

There are many things that we can reuse. I have eight here: first, all the work that we have done on improving data quality; second, the frameworks for managing assumptions; the third point is the model quality – we have worked hard to validate the results of the model, as we have done for data; fourth is the governance of data, assumptions and models; fifth is the process we have for developing models; the sixth point is the industrialisation of the models – we have streamlined the process of parameterisation; seventh is the IT infrastructure we have in place; eighth is all the links we have introduced between accounting and actuarial teams and the storing of calculations in new accounting systems.

We have spent a lot already, so the main difficulty for us today is to knock again at the door of the CEO and ask for money. ■

Thomas Behar



InsuranceERM events

Insurance Risk & Capital, Bermuda

20 October 2017, Hamilton Princess Hotel, Bermuda

TOPICS TO BE DISCUSSED:

- Insurance Outlook 2018
- Staying ahead of the curve: identifying the risks of tomorrow and examining how those risks are transferred/underwritten
- Innovation and change in the insurance industry
- Rigour and robustness around reporting and modelling
- Risk culture and the changing role of the CRO
- Bermuda's regulations for underwriters
- Implementing new capital standards
- Cybersecurity: examining the risks and opportunities
- Overcoming the challenges around group supervision in an uncertain geopolitical environment

CONFIRMED SPEAKERS:

Brett Henshilwood, Partner, Deloitte
Dean Roberts, Business Development Executive, Aon Benfield, London
Edward Mishambi, Vice President, Head of Risk & Regulatory Affairs and Assistant Treasurer, RenaissanceRE
Heejae Cho, Underwriter and Actuary, Arch Reinsurance Ltd
Elisabetta Russo, ERM Advisor, NAIC
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