Lessons for the future

Preparing for IFRS 17

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As the forthcoming IASB insurance contracts standard, IFRS 17, enters the final stages before publication, possibly in May 2017, there has been a significant increase in activity from insurers around the world. Insurance companies are gearing up their change programs and thinking long and hard about how they should implement the new standard, for many, together with IFRS 9 on Financial Instruments.

At this point, it is important to take a deep breath and consider how to respond to the challenge of new reporting standards that have come hard on the heels of other business transformations. Based on KPMG professionals' experience working with insurers around the world on a wide range of complex transitions, such as Solvency II implementation, post-merger integration, and major programs of finance and actuarial transformation, we offer thoughts on possible next steps and some lessons for the future to consider when planning for IFRS 17 implementation.

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The state of play

The plans KPMG professionals are currently discussing with insurers range from an assessment of the full impact of IFRS 17 and IFRS 9 on group-wide processes, to selected assessments of specific topics, sometimes at the group level alone or in a few selected countries. Frontrunners are already planning how they will operationalize the new standards but equally there are a large number of insurers delaying their preparations following the current year-end close and waiting for IFRS 17 to be published.

The wait-and-see approach is particularly common in Europe, where many insurers are still recuperating from their first full year of Solvency II. Mindful of lengthy, expensive and sometimes painful Solvency II experiences, we discussed the relevant issues with a number of financial reporting executives at large insurance companies (Achmea of the Netherlands, Manulife of Canada, Munich Re of Germany, and Royal London of the UK) to exchange views on what the insurance industry can learn from the previous change programs. We believe there is much to be gained for the industry as a whole in collaborating to share best practices, to discuss the pitfalls and how to avoid them.

IFRS 17 has the potential of creating greater transparency and comparability in financial reporting, lowering the cost of capital, and accelerating changes in the finance and actuarial functions to enhance efficiency. However, many insurers are skeptical about the potential benefits of the forthcoming accounting change although KPMG member firms see forward-thinking insurers looking to capitalize on these developments.

Greater standardization is the goal for many insurers to unlock efficiency savings, and IFRS 17 has the potential to deliver greater consistency between local and group reporting and even between different operating units for those groups that currently report using their local generally accepted accounting principles (GAAPs). The building block approach of IFRS 17, European Embedded Value (EEV), Market Consistent Embedded Value (MCEV) and Solvency II all share similar elements, namely cash flows, the discount rate and risk margin. They also face common challenges, namely the determination of boundaries for estimating cash flows, the selection of appropriate discount rates (including the approach to liquidity premiums) and risk margins. The key differences are that IFRS 17 contains the concept of contractual service margin (CSM) to prevent day one gains and significantly greater rigor around the grouping of contracts. The extent to which the production of these metrics can be aligned offers important efficiencies.

But IFRS 17 also has the potential to drain large amounts of money and occupy many people over a long period of time. And while there are benefits that can be associated with the change, many in the industry do not yet see a compelling case for business benefits nor even the need for a new insurance standard. Yet, they realize the need for a comprehensive overhaul of their finance and actuarial systems architecture and substantial IT involvement because of the immense changes IFRS 17 is going to bring about. **"If you view it simply as a reporting exercise, you're not going to be able to deliver it: IT needs to be at the table," says Lisa Wardlaw, Vice President and Treasurer at Munich Re, US (Life) in Atlanta, Georgia.**

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More than just compliance

Despite the prospect of transformation, a large-scale change program that some may consider a compliance exercise will have to compete with other priorities for funding. The search for growth, the need to innovate and respond to insurtech, renewed focus on costs and efficiency and the requirement to comply with other, new regulations that have earlier deadlines may lead to significant competition for resources, human and monetary. **"What we learned from Solvency II is that it will help to keep the end state in mind when thinking about the reporting requirements and the data that you need for that," says Corinne Weeda-Hoogstad, Director Reporting at Achmea.**

When all of these elements are combined with the near 20-year incubation process for IFRS 17, it is understandable that some insurers may feel reluctant to launch yet another large project. But, as in any big change over a long period of time, there is concern that this inertia may lead to unnecessary risk, expense or stress later on. This may happen when it becomes clear that there is a good reason for the three and a half year implementation period that will be provided for in the standard. The accounting change envisaged is fundamental and its impact is profound. **"Don't just look at what's in front of you, but look 360 degrees around you, above you, and below you before you engage in a program of change, to make sure that you are really going to transform everything around that process," says Jon Bradbury, Project Leader, Valuation System Transformation, at Manulife Financial.**

Avoiding past mistakes

"The insurance industry cannot afford to put off the task of planning for another day."

What is to be done? First, the insurance industry cannot afford to put off the task of planning to another day. Nobody can afford to stand still. Instead, executives could start by examining what has worked well in previous large-scale projects and how previous mistakes can be avoided this time around. Of course, there is no single answer, since each company's situation is unique and each has a different starting point for its journey.

No matter where your starting point, one very important element to consider is how the company has embedded its current value reporting — whether it is Solvency II, economic capital, or embedded value — in its current accounting framework. Can the company leverage valuation and reporting elements that are already in use, and if so, where exactly does it need to change, redesign or upgrade its existing actuarial, finance and reporting structures? Few, if any, companies will have the luxury of starting from scratch, but if a wholesale transformation of the finance architecture is planned, how can it be confident that it will deliver the desired end state?

Companies with robust Solvency II calculation engines will be able to use much of the information they already have available for the forthcoming accounting change program. **"Implementation of Solvency II will make it easier to achieve the transition to IFRS 17, not because of any technical comparison, but because we've had to totally upgrade our finance accounting and actuarial systems. And you would have to hope that previous changes would make it easier to report on a new accounting basis, because we have newer and more flexible technology," says Tim Harris, Group Finance Director at Royal London.**

Some insurers will use the implementation of IFRS 17 to enhance their Solvency II reporting process. But at the other end of the spectrum, there are those that have designed their Solvency II, economic capital or value-based management processes to sit on top of their current accounting and actuarial framework and reporting. This is where things may become more painful, as IFRS 17 will force these firms to redesign from the foundations up. And while they do this, the roof needs to stay intact. Furthermore, after the redesign, insurers may use IFRS 17 implementation to enhance Solvency II reporting.

Lessons for the future

Based on KPMG member firms' experience in working with insurers on large change programs, we have found a number of lessons in common that should prove useful for the implementation of IFRS 17. These include:

1. **The success of a large project depends on good leadership.** This requires a commitment to a vision of what the company's systems should look like at the end of the program. It requires the company's leaders to stay involved in the project from beginning to end and to be open to new ideas throughout the process.
2. **Do not view this as an actuarial, finance or compliance project in isolation from other parts of the business.** IFRS 17 is as much an IT and data management project as an actuarial and finance project. And don't forget the technical aspects of complying with the new requirements, especially as principles and their interpretation are applied for the first time. The analysis and design of the solutions need to be seen through all of these lenses.
3. **Take the process one step at a time, test and learn, and then take a new step.** Do not design massive changes to systems and processes before knowing what the company is aiming to achieve at the end of the process step. It may be necessary to back up and change direction after gaining fresh insights of what needs to be done — and this is what we mean by test and learn.
4. **Do not allow the IFRS 17 program to become so big that people lose sight of its objective.** This requires a clear vision towards the objective that the company is working toward and rigorous project management over a long period of time to prevent 'scope creep'. **"Solvency II shows us that there is a good chance to get things right for other initiatives as well, but they can also become too big. You have to be careful to avoid having people add their pet projects," says Weeda-Hoogstad.**
5. **Take enough time to prepare the ground at the beginning.** Getting started can be a challenge (see next page) and the start of the program can appear daunting, but it would be worse to find out late in the day that the company could have fundamentally re-thought some of its current processes. A comprehensive and detailed gap analysis is often the most critical project element to get right.
6. **Developing a 'living' plan, including realistic time-scales, clear accountabilities and sufficient time to test and learn, forms an effective blueprint for success.** Consider using two versions of the project plan, one as a high level multi-year milestone plan for communication to stakeholders such as audit committees, and one at a more detailed level for day to day operational management of the project. We would suggest revisiting the details at least every two weeks or else it will quickly become redundant. Having a large-scale physical representation of the plan clearly visible for project team (e.g. on brown paper) will help to keep it alive.
7. **Do not imagine this change can be performed solely in spreadsheets.** For sure, spreadsheets have a role to play in agile experimentation and prototyping and can enable a company to get substantially down the path towards full implementation. But this is not enough to sustain a once-in-a- lifetime change to a company's primary reporting basis. The end date is fixed, results will need to be audited, and trying to complete the final 20–30 percent of the project using spreadsheets would create unsustainable operational, reputational and regulatory risks.
8. **Changes in circumstances are inevitable.** Given IFRS 17's implementation timescale, it is likely that new talent will need to be brought on board to avoid change fatigue — and some of those who are involved at the start of the project will have moved on for new roles before completion. Careful thought needs to be given to documenting key decisions and working assumptions and to forming a consistent set of views, without becoming too rigid.

Getting started – ask the right questions

The implementation of IFRS 17 and IFRS 9 looks daunting and begs the question, where do I begin? The following questions should give you a good starting point to generate discussion within your organization and get the ball rolling!

12 questions to kickstart your successful transition to IFRS 17

1. **Do you issue non-profitable contracts?**
   If you currently include these in a profitable portfolio, you may need to account for them separately.
2. **How granular will your disclosures of profitability need to be?**
   You might need to report at a more detailed level.
3. **Will IFRS 17 make your financial results more volatile?**
   What accounting policy choices could you make to reduce this?
4. **How will your KPIs change?**
   How will you help your users understand these changes?
5. **Are you using an asset-based discount rate for your liabilities?**
   Consider the impact on equity if such a rate is no longer permitted.
6. **How will IFRS 17 affect the way your assets and liabilities interact?**
   If you liabilities shift, you may need to change your asset mix.
7. **What accounting mismatches could result?**
   Have you explored your options under both IFRS 17 and IFRS 9 in order to reduce any accounting mismatches?
8. **How diverse is your insurance portfolio?**
   The more lines of business and product versions you have, the more time you're likely to need to implement.
9. **Is your historical data easily available?**
   If not, your transition options may be limited.
10. **Who manages your financial and embedded value reporting?**
    Leveraging these resources and data will be vital for reporting under IFRS 17.
11. **What big changes have you navigated recently?**
    Are there synergies you can unlock? For example, from Solvency II?
12. **Do you have sufficient resources and budget?**
    Can you build your initial budget and resource estimates by extrapolating from previous change programs?

Mapping your insurance change program

Experience indicates that in order to digest the implications of changes of the magnitude of IFRS 17 and IFRS 9, organizations will have many questions. Our methodology acts as a compass to help ensure answers to these questions are focused and well-targeted and take into consideration program interdependencies and broader business implications.

If implementation of IFRS 17 and IFRS 9 is to reach the best possible outcome for your organization, we believe that it needs to be seen as more than just a compliance exercise. This means combining multiple strands into a common program, identifying linkages and addressing dependencies across the business in a logical sequence and thinking strategically about the possible effects on the organization and its stakeholders.

Our flexible approach offers our firms' clients a well-established and adaptable methodology to confidently tackle changes that otherwise might appear daunting.

The initial **Assess** phase is of great significance: identifying accounting, actuarial and reporting differences; assessing the data, IT systems, and processes needed to generate the new results; the key impacts for the business and how these will be influenced by the choices open to you and identifying the skills and resources needed to bring about the change.

Source: KPMG International.

Next steps in transformation

There is, in sum, much to be learned from a company's experience with previous large financial transformation projects. The trick is to take these lessons to heart and apply them to their plans for implementing IFRS 17 and IFRS 9. We strongly recommend that every insurer should carefully examine their large transformation projects from the past five to 10 years and consider what worked well for them, and be honest about what did not, then use these insights to guide their future course towards IFRS 17 and IFRS 9.

Our overarching message is to be extremely conscious about the working assumptions and choices that are made at the start of the project and why they have all been made. A clear vision of the end state can help provide the direction. Companies should then test and learn as they steer a course in as straight a line as possible over the following four years. This requires insight, vision, experimentation and consistency over a long period of time. A challenge for any industry.

KPMG professionals can help you navigate this complex process of IFRS 17 and IFRS 9 by leveraging a tailored methodology to consider the impact for your business in a structured and efficient way, providing advice that is tailored to your business and your strategic objectives.

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