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Finance, risk, and actuarial modernization: The benefits of an integrated approach

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What is your company's budget for modernization? With IFRS17 now a reality and FASB's Long Duration Contracts project coming into view, many insurers are seeing potential compliance costs escalate to hundreds of millions dollar. CEOs are rightfully asking what benefits, if any, they will get from such a significant investment.

Astute insurers realize that they can use the IFRS/FASB requirements as a catalyst for change and that the most effective and efficient use of their investment will be to consider what they deliver to their business partners and modernize in an integrated manner.

Traditional approaches to modernization typically have seen individual functions working in silos to develop modernization plans that alleviate the pain points in existing processes. Such approaches have paid inadequate attention to 1) the inter-relatedness of processes, functions and reporting across the finance, risk and actuarial functions, 2) developing a wider vision that aligns the collective interests and priorities of the finance, risk, and actuarial functions, 3) the expectations of all stakeholders, particularly the business insight they seek, and 4) a roadmap that recognizes the enterprise-wide overlaps/gaps of various inflight projects.

In contrast, an integrated modernization approach requires interaction among different functions to create a future state vision, roadmap and business case that aligns their different interests and satisfies key stakeholder expectations. Specific benefits of an integrated approach to modernization include lower costs, greater efficiencies, adaptive technology solutions, better risk management, more effective use of resources, and better business insight.

We describe below the benefits of modernizing the finance, risk and actuarial functions in an integrated manner, as well as the key steps that characterize this approach.

Efforts to modernize functions in silos instead of holistically increases the chance of future inefficiencies and disruption.

The case for change

The need to comply with new accounting and regulatory developments has traditionally been the driver of change. This certainly remains true with the release of the new IFRS 17 standard. Costs are expected to run into the hundreds of millions for firms depending on their scale, complexity and current technology capabilities. Aviva CFO Tom Stoddard recently told the Financial Times that "we spent £500 million on Solvency II. This won't be quite that amount, but it will be another large number."

Considering the size of investment, we are seeing CEOs expect results that go beyond minimum compliance. They expect finance, risk, and actuarial functions to become more relevant to the business through timelier reporting and insights that help communicate the value of the business to external stakeholders. To meet this aspiration and deliver enhanced capabilities across the organization, adopting an integrated approach to modernization is essential.

There are several examples of a siloed approach to modernization leading to inefficiencies. A case in point is some European insurers' implementation of Solvency II. They had the chance to replace legacy IT systems from the 1980s and 1990s, but many of them chose to upgrade existing systems or bolted on new ones. As a result, making a further systems change – which will be necessary to meet new IFRS 17 requirements – will be both challenging and costly.

Another key risk of adopting a siloed approach to modernization is overinvesting in one function at the expense of another. For example, building a state of the art investment function at the expense of supporting risk capabilities may lead to ineffective risk management and could severely hamper management's ability to make informed business decisions, optimize capital, and/or manage the business through a change in economic environment.

While an integrated modernization initiative requires substantial executive commitment, funding, and time, approaching operational change holistically can provide a significant return on that investment by promoting better business practices, more openness to and ability to affect innovation, and a tangible competitive advantage. For example, we are aware of a large global insurer that is transforming its finance function with the goal of achieving a 5-day reporting close (instead of the industry standard of greater than 30 days) for all regulatory and internal valuations. To achieve this investment is required beyond finance as other functions provide information critical to the close activities.

In light of initiatives like these, insurers should consider what competitive disadvantage they may face if their peers successfully modernize and are able to deliver better and timelier business insights. In our experience, an integrated modernization approach safeguards against this and is the most effective methodology to achieving a mutually agreed future state that meets strategic priorities, collective goals of key stakeholders, and is adaptable to an ever changing market environment.

CEOs want finance, risk, and actuarial functions to become more relevant to the business and better engage with stakeholders to communicate its value.

Integrated modernization versus traditional modernization approaches

An integrated modernization approach drives more consistent, standardized, and efficient outcomes by aligning the impact of the change across all functions and leverages the benefits from consolidation of activities and technology solutions. Traditional approaches struggle to succeed because they address too narrow an issue and ignore how other stakeholders' strategic objectives could be achieved if the program also took them into account.

"Changing the wings while flying" or incorporating new and complex operational and technology changes while dealing with ongoing operational and development pressures challenges even the most efficient organizations. It is therefore imperative to develop an integrated strategic plan, roadmap and blue print of supporting technology needs that clearly sets out the staging and phasing of activities to address the potential complexity of ongoing initiatives across divisions.

In an integrated modernization, executive management is engaged and there is an appropriate level of interaction among different functions.

Perhaps the most important difference between an integrated modernization approach and the approaches most insurers have followed to date – and a key determinant of success – is the level of cross-functional executive management sponsorship and engagement that facilitates the appropriate level of interaction among different functions.

Developing a modernization strategy that provides a path to real change includes visualizing a compelling future state, articulating and communicating expectations, defining a roadmap with achievable goals, articulating the supporting technology requirements, and avoiding overreach during the implementation.

Traditional Modernization Approach

- C-suite not informed or limited involved
- Siloed projects
- Single-solution oriented
- Stakeholders have limited involvement
- Data, systems and processes developments not aligned
- Not cost effective
- Difficult to embed

Integrated Modernization Approach

- C-suite informed and involved
- Cross functional project management and execution
- Alignment of stakeholder objectives and priorities
- Alignment of data, systems, and process developments
- Lower overall costs
- Easier to embed

Steps to modernize in an integrated manner

1. *Ensure executive management involvement.*

   An integrated modernization approach is by definition far-reaching and will result in a noticeable change to an insurer's people, processes, data and systems across many core functions. Because of the scale of change, it is imperative that executive management is engaged as early as possible in order to:

   - Drive and promote interaction among finance, risk and actuarial leaders;
   - Appreciate the impacts on the organization's future operating model and culture;
   - Confirm external stakeholders expectations, thereby validating that their expectations align to the project's strategic vision; and
   - Provide the required level of support and sponsorship for a successful roll-out.

2. *Develop an integrated future state vision, road map and technology blue-print that is agreed upon by finance, risk and actuarial.*

   After obtaining executive management's support and confirming external stakeholders' expectations, the next step is to develop a future state vision that aligns finance's, risk's and actuarial's interests and priorities. This will occur when senior management representatives from each functional team carefully articulate the future state needs of their respective areas and identify areas of common need and interest. From our experience, areas of commonality tend to include data that provides a "single source of the truth," consistent assumptions, consolidated calculations platforms, centralized processes, and information warehouses.

   Execution of the vision requires a comprehensive roadmap with prioritized and suitably phased workstreams; a dedicated implementation team; and an appropriate business case and budget. A blueprint for the supporting technologies should be specified that can support the overall business requirements.

3. *Project Rationalization.*

   Review the mandates of existing change programs to ensure they align with the new vision and roadmap. Too many other priorities are a barrier to progress, but these other priorities are often disconnected efforts that, if brought together and rationalized, ultimately can support an integrated solution.

4. *Translate strategic objectives into operational processes and technology requirements.*

   Business and IT often do not have a common language to specify, understand, and translate strategy into operational implications and then technology requirements. A good way to provide one is by developing "user stories" (consistent with Agile methodology) that appropriately capture the types of outcomes the business is looking for from operational and technology changes. For example, a typical user story for a valuation process is, "As a valuation actuary, I want to leverage a consolidated data source for input data used in the valuation process so that I can avoid multiple data reconciliations."

5. *Review target operating models and incentive plans.*

   Target operating models will need to be enhanced to take greater advantage of new capabilities, technology, and ways of working that leverage operational efficiencies and allow resources to be redeployed to higher value-adding work. Further individual behavior and actions are governed by incentives of one form or another, and those incentives will need to be changed to reflect the new world and support the holistic objectives of the integrated modernization program.

6. *Get the right skills*

   Typically, a firm may have limited resources with the necessary skills to manage the complexity of such a large-scale transformation program. Firms that have successfully carried out these project have partnered with strong advisors that can help steer, manage and challenge the project execution. A strong advisor can help firms avoid common pitfalls that could kill a project before it gets off the ground, help build momentum throughout the implementation, and manage messages to internal and external stakeholders.

7. *Target "quick wins"*

   Many modernization journeys fail because they're multi-year programs but the business only sees benefits towards the end. Rather, a successful modernization initiative carefully phases and stages three- to six-month tactical "quick wins" that provide tangible benefits and build confidence in the execution capabilities of the implementation team.

Integrated modernization results in more efficient data, systems, processes and operating models that are better equipped to deliver greater business insights and support a firms' management met its strategic objectives.

The benefits of integrated modernization

Modernization projects have moved beyond a "nice to have" and are increasingly necessary for insurers to meet new regulatory and financial reporting requirements, as well as to effectively and efficiently produce and analyze the metrics the organization needs to adequately price risk and manage the business.

An integrated modernization approach can give an insurer a significant competitive advantage through:

- Cost efficiencies, from taking advantage of natural overlap among functions and avoiding duplication of effort and unnecessary disruption;
- Future adaptability, notably the flexibility to meet new accounting and regulatory compliance needs and stakeholder expectations;
- Efficiency gains, including process consolidation, streamlining and automation, and strengthened internal linkages and reduction of internal silos;
- More effective use of human capital, which will be more keenly focused on analysis and business insights, and
- Internal consistency of metrics, reporting and reconciliations.

While meeting the demands of current business pressures and regulatory demands under a single modernization initiative is an involved process, the benefits to approaching operational change holistically will promote better business practices, greater innovation, and ultimately provide a distinctive competitive advantage.

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For more information on finance, actuarial, and risk modernization, as well as PwC's insights into modernization, please see our insurance modernization site.