Achieving convergence of finance, risk and actuarial functions: beyond transformation

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Achieving convergence of finance, risk and actuarial functions

Beyond transformation

C-suite executives and senior leaders in finance, risk and actuarial are under intense pressure to navigate a wide range of megatrends and market forces, ranging from increased regulatory requirements and low interest rates to globalization and the disruption caused by new market entrants. Because traditional transformation programs are not sufficient for these new business realities, insurers must fully converge finance, risk and actuarial operations — essential business functions that traditionally have worked in silos.

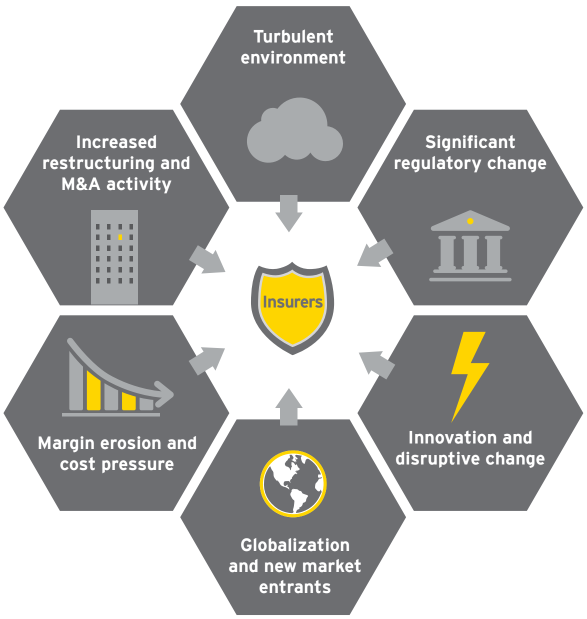
It is imperative that finance, risk and actuarial come to share a common set of core data, underlying infrastructure and shared assumptions. Otherwise, leaders of these functions will struggle to meet the needs of internal stakeholders and external regulators, and to improve performance in meaningful ways.

Beyond the near-term challenges, integrated transformation efforts also set the foundation for next-generation operational models, data-driven decision-making and other capabilities necessary to conquer the daunting competitive challenges the industry faces. A few insurance leaders have shown the way forward, by driving fundamental and permanent changes at the operational level and adopting convergence. The results included significant capital freed up for strategic redeployment, increased organizational agility and optimized cost structures. These insurers are better positioned to address ever-evolving market and business challenges.

This article will describe business drivers and trends that make the convergence of the finance, risk management and actuarial functions an imperative for insurers and provide insights on the necessary steps.

The trends and drivers that demand transformation

Insurance market landscape: a range of powerful and interrelated forces challenge insurers today



For many insurers, the impetus for transformation is a combination of powerful and interrelated forces, including:

- Turbulent macroeconomic conditions marked by persistently low interest rates
- Significant regulatory change — International Financial Reporting Standards, Solvency II, Own Risk and Solvency Assessment and systematically important financial institution designations, to name a few
- Disruptive change represented by innovation, new technology (such as FinTech), non-traditional competitors and new market entrants (such as robo-advisors)
- An increasingly globalized marketplace
- Low margins and ongoing cost pressures
- Increased restructuring and M&A activity
- Intensifying competition for scarce talent — especially for specialized actuarial resources and senior finance and risk executives

Typically, each of these forces is addressed by a stand-alone change program or initiatives undertaken by finance, risk or actuarial individually. Each group tries to solve the problem on its own, rather than taking a holistic view of the issues or coordinating strategies and investments to solve the problems.

Rising demand for integrating finance, risk and actuarial functions

These forces have also led to extraordinarily high demand for the services provided by finance, risk and actuarial functions, especially in the analytical realm. There is intensifying demand for specific and consistent data from both external and internal stakeholders.

- Regulators require new data, which insurers often struggle to provide accurately or efficiently. Plus, regulators are increasingly attuned to inconsistencies in data provided by the same company's risk and finance teams.
- Business leaders are looking for insights regarding capital optimization for restructuring or rationalizing legal entities, as well as relevant and timely performance data and forward-looking information to make the most of M&A and other opportunities. And they want it faster because they must make decisions more quickly to keep up with the accelerated pace of change.

The rising demand is a long-term trend that shows no signs of abating and continues to strain the organization. It is no surprise that it has served as a final tipping point or catalyst for change. But transformation must focus on full convergence. Unless finance, risk and actuarial operate from a common set of core data, underlying infrastructure and shared assumptions, functional leaders will continue to struggle to satisfy regulatory reporting requirements and internal demands for more and better information.

Breaking down silos and eliminating redundancies

The large-scale transformation programs that many insurers have undertaken have mainly addressed these issues in terms of the individual functions. In some cases, redundant processes across these groups have been made more efficient, but they remain redundant. The bigger payoffs can only come through transformation efforts that integrate processes, establish enterprise-wide standards and converge these functions, rather simply optimizing within individual functions. The key premise is that all three groups use the same foundation of data, technology and processes for reporting.

The downside of silos

Without such convergence, finance, risk and actuarial teams may continue to work in silos, resulting in:

- Ongoing skepticism about each other's outputs and findings
- Continuing failure to communicate and "speak each other's language"
- Rising overhead and opportunity costs as the same models are rerun and divergent models are manually reconciled or adjusted through workarounds
- A lack of standardized data and clearly defined controls; no single or fully credible version of the truth
- Senior management uncertainty about which data or reports to trust as it confronts critical strategic and tactical decisions
- Regulatory pressure to explain different answers to the same questions

Collectively, these risks may lead to transformation investments delivering subpar returns or change programs failing outright.

Consider how the current state plays out in investment asset management, for instance. Finance is mainly interested in the reporting of financial results and the impact of assets on balance sheets, while actuaries are focused on how asset value can be used to cover liabilities, and risk groups want to evaluate the pros and cons of the investments in assets. Because there is limited collaboration, each group uses its own processes and models to generate the reports and analytics it seeks. The end results may be suboptimal investments and a treatment of assets that may vary from the balance sheet to the reserve estimates.

Even the closing and reporting processes are complicated and compromised when different functions use different sets of numbers. Here again, each function focuses on its own goals — finance on conducting the close and reporting, actuaries on setting the reserves and risk management on producing risk analytics and reporting. The fragmented and duplicative approach greatly increases the likelihood of incorrect or inconsistent results and inconsistent storylines, which in turn lead to still more rework to address variances.

These circumstances were once merely an inconvenience, but are now formidable challenges, notable for both increasing costs and higher risks.

How insurers arrived here and how to move forward

To be clear, the lack of alignment is a legacy issue, stemming equally from:

- Outdated and inflexible information technology (IT) infrastructures, which make it difficult to easily access necessary data or share common data sets
- Historical M&A activities that have not been fully integrated
- Organizational structures and competing agendas that inhibit coordination between these groups and can lead to mutual mistrust

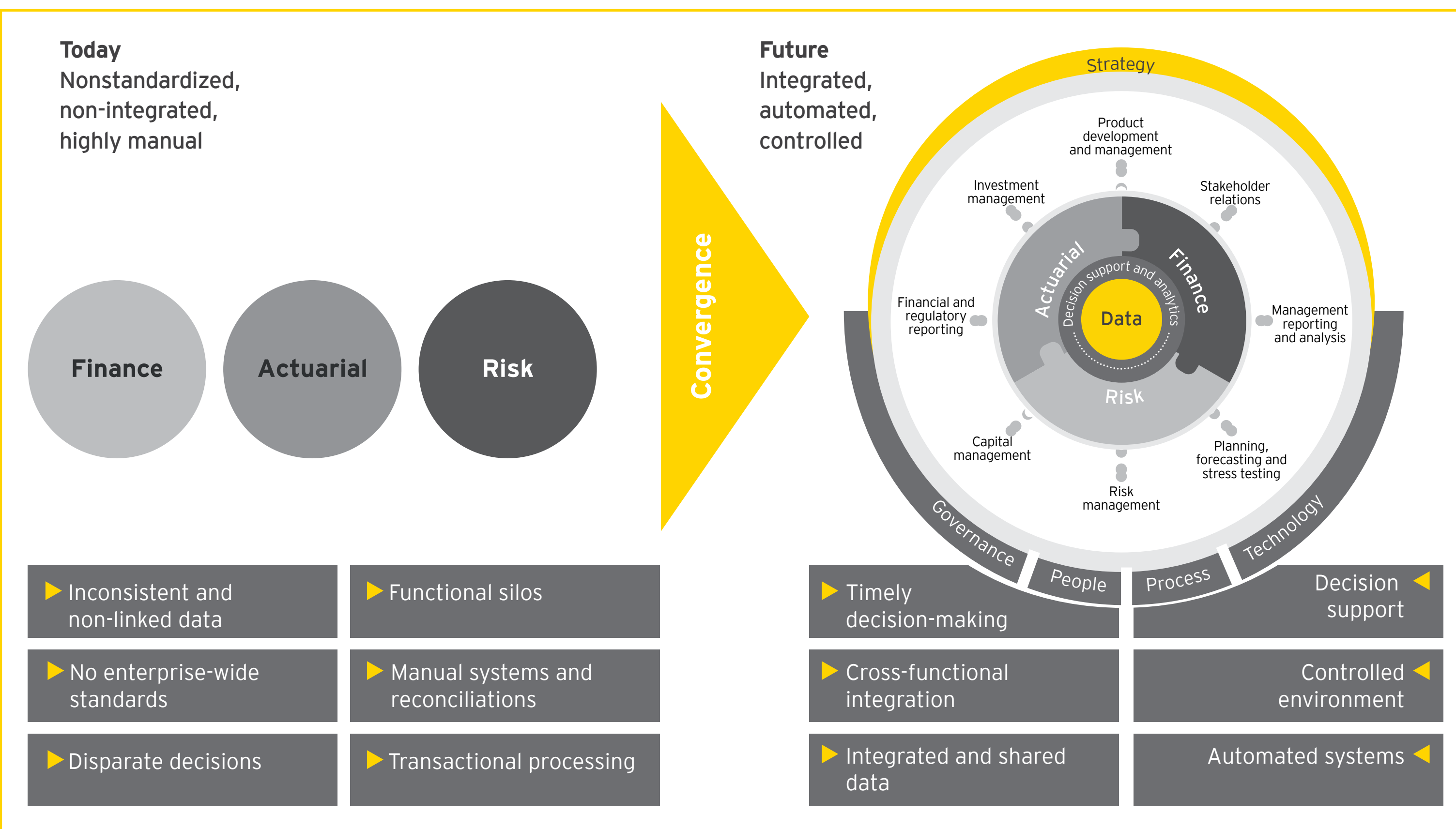
These deeply entrenched barriers mean that insurers must undertake a broad-based transformation program that will extend beyond narrowly defined change initiatives within single functional areas. Further, they must address:

- Process and policy concerns
- Data and technology issues
- The "people factor"

Such a multidimensional and cross-functional approach offers a clear upside for the business. Significant potential benefits can result from increased efficiency, lower costs and easier compliance. In other words, the convergence of finance, risk and actuarial operations should not be viewed as a compliance exercise, even if regulatory demands are the "final straw" forcing insurers to act; rather, it should be viewed as a performance improvement opportunity. Having better data about capital, for instance, not only streamlines regulatory responses, but also provides valuable insights back to the business.

A few forward-looking and early-adopting insurers have demonstrated the value proposition for convergence by freeing up significant capital for investment in other strategic priorities. They have also reduced costs through more accurate reporting of assets, clearer visibility into risk and performance, and better allocation of resources. The increase in data quality has led to higher decision-making confidence on the part of senior leaders and greater organizational preparedness to meet the challenges of the next five years.

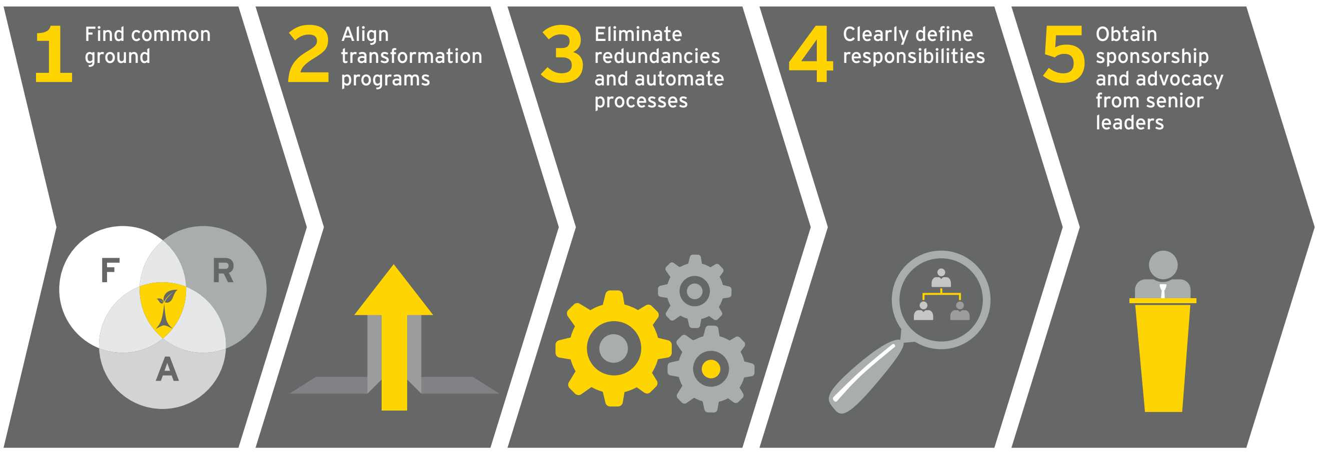
A vision for convergence: the value is in the shift from fragmented to integrated processes and from siloed to common data and infrastructure



First steps on the road ahead

Because every insurer has distinctive organizational models, IT infrastructure, cultures and business objectives, there is no predetermined formula for converging finance, risk and actuarial functions. And it won't be an easy change, given the wide and long-standing gaps between the groups. However, there are certain proven steps that are likely to lead to transformation success, based on the experiences of early adopters.

Moving forward: five steps to converging finance, risk and actuarial functions



Moving forward: five steps to converging finance, risk and actuarial functions

1	Find common ground	First and foremost, leadership of finance, risk and actuarial must work to better understand each other's perspectives. Serving as better advisors to the business, as EY research has shown these leaders want to do, necessitates deeper and broader understanding across functional lines. The common goal of bottom-line business success is one clear guiding principle. Once a baseline level of trust and shared purpose is established, conversations can — and should — naturally turn toward operational matters with a common goal. Specifically, that means defining common views of policies, processes, data and technology. The closing and reporting process is a great place to start, perhaps in a cross-functional workshop environment, with clearly achievable benefits and incentives for each group.
2	Align transformation programs	The significant number of transformation programs already under way within the finance, risk and actuarial functions represents another opportunity to coordinate. This may involve pooling investments for data integration or new technology implementations. Collaborating on governance models and policies or standardized controls can also be a valuable exercise. However, the big strategic idea is simply that transformation programs must encompass finance, risk and actuarial collectively, rather than be conducted alone by individual functions.
3	Eliminate redundancies and automate processes	The center of excellence model, which has certainly proven its worth within these individual functions, must similarly expand to reach across organizational walls. In the future, shared services operations or centers of excellence for end-to-end and cross-functional processes may become important elements of the operating models of industry leaders. The models used by finance, risk and actuarial will be built with consistent data and common underlying assumptions for calculating loss ratios, reserves and the like. Yes, some parallel processing will remain, and each group will apply its unique experience, but redundancies and risky rework will be eliminated to seize the compelling cost savings, efficiency gains and accuracy improvements that are there for the taking. In general, processes will be more automated and flexible, as well as smarter and faster.
4	Clearly define responsibilities	This is not to say that accountants will be expected to act as actuaries, or vice versa. Rather, each group will do what it does best and maintain oversight of specific areas in which it is most qualified. But all of these groups will work from the same core data and consistent baseline assumptions, enabling everyone to work from a single version of the truth.
5	Obtain sponsorship and advocacy from senior leaders	Any change of this magnitude requires organizational work, as resistance to change (not to mention political issues) is a common barrier to success. To a large extent, convergence is about teaching each of these groups to speak each other's language and understand each other's points of view. Until that happens, individual functions may continue to insist that they have unique data needs and resist process integration. For all of these reasons, highly visible sponsorship and advocacy from senior leadership are necessary to define the big-picture vision, build momentum once convergence programs start and remove organizational obstacles along the way.

Bottom line: convergence in a time of change

If insurers are to navigate the profound and rapid market shifts and regulatory head winds, they must rethink and transform their legacy operating approaches. And they must take a holistic and integrated approach to transformation if they are to deliver value from these significant investments. The most powerful change they can make is the convergence of finance, risk and actuarial functions. The end goal is a consistent, unified and controlled environment where all three functions do their essential work starting from a foundation of common enterprise data sets, technology and architecture, governance models and processes. The payoffs will come in the form of more efficient and cost-effective compliance with increasing regulatory demands, better insight into the business and enhanced decision support capabilities.

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