



The upside of  
accounting change:  
agile and modernized  
finance technology to  
drive better business  
performance



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**By providing more extensive detail of financial results, IFRS 17 and long-duration targeted improvement (LDTI) or accounting change – will transform the financial statements of life and health insurers, certain property and casualty insurers and Reinsurers, with significant implications for investor perceptions and executive priorities throughout the insurance industry.**

While possible to view accounting change as a compliance exercise, nearly all insurance companies are viewing these changes as the trigger for long-overdue deferred investments ranging from targeted data, system or process upgrades to full-scale modernization. Accounting change is also an opportunity for management teams to identify opportunities to transform their operating models, along with the role of finance, risk and actuarial in their businesses.

As for the timeline for making these investments, although the prescribed effective dates have been deferred and many local adoption approaches are still uncertain, there's no room for delay in working through the significant effort required.

Participation across business units and organizational functions will be essential for adapting to accounting change. Instead of an unstructured approach led either by actuaries, accountants or IT specialists, what's required is a cross-functional approach based on a business case to modernize operations with flexibly architected insurance solutions that integrate finance, risk and actuarial functions throughout the business.

This modernization approach goes beyond compliance. To adequately address accounting change, insurers will need to capture ongoing insights from finance, risk and actuarial resources; monitor and guarantee the quality and timeliness of data collected; upgrade the systems that deliver that data across a wide audience of internal and external users; and design processes that consolidate accounting information into reliable, insightful reporting that contributes to better decision-making on a timely basis.

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# Implications of accounting change

Regulators have published new guidance for the accounting for insurance contracts under both IFRS and US GAAP, and these changes are expected to result in increased volatility in financial results and shareholders' equity, particularly for life and health insurers. This will result in heightened scrutiny by internal and external stakeholders over the judgments, data, systems and processes used to measure insurance assets and liabilities. In response, management may need to reconsider pricing, business mix, sales channels and other characteristics of the business. Only time will tell which responses will be most appropriate, but it is certain that senior leadership will need timely and insightful data to inform its decisions.

Overall, insurers that are better able to articulate their investor story, accurately steer consensus expectations and proactively address implications of the new accounting and reporting regime will undoubtedly have a competitive advantage against peers.

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# Customized technology solutions

Accounting change represents a fundamental transformation not just in financial statements, but in how insurance companies operate. It's a big deal requiring integrated business processes – and the companies farthest along are the most concerned about what it'll take to implement.

The core challenge is that older accounting systems were built to aggregate actuarial and risk data for external financial reporting without the capacity for more granular estimation of the underlying cash flows. Meanwhile, older front-end business systems built to collect transactional information typically lack the precision or efficiency needed for integration with accounting systems. These legacy platforms, either on the accounting side or the business side, will be hard pressed to handle increased transparency and requirements for more precise data while still meeting quarterly and annual reporting deadlines.

Accounting change will require insurers to take a different approach to measuring and reporting insurance and reinsurance assets and liabilities using more granular data, assumptions and models, while using current, supportable inputs. To do so, insurers will need to implement an industrialized approach to actuarial modeling that captures business and accompanying financial information at a more granular level of detail, to be summarized and made available to investors on an ongoing basis.

Measuring and reporting operations with respect to these complex concepts will require an accounting rules engine integrated with business systems. The result will be a tighter connection between business events (i.e., transactions) and financial reporting.

Standing up a rules engine between legacy front-end and accounting systems is a significant endeavor, and one that few firms with legacy systems would be able to complete to meet the upcoming IFRS 17 and LDTI deadlines. Unless an insurer has completed an end-to-end transformation within the last five to seven years, accounting change requires modernization, not modification. By far, the fastest and least expensive path to modernization will be to utilize flexibly architected, cloud-based actuarial and accounting solutions.

## Modernized insurance solutions:

- ▶ Run in the cloud, substantially reducing the cost and time of delivery while generating tangible expense reductions
- ▶ Allow convergence between finance, risk and actuarial functions through cloud-based APIs and other approaches to connectivity
- ▶ Support “straight through” automated financial reporting to meet the requirements of accounting change

Deployment of a modernized solution is by no means a straightforward proposition, as the software requirements will be dependent upon the specific characteristics of each underlying line of business. Accordingly, there's no single off-the-shelf rules engine currently supporting the entire range of business requirements for accounting and reporting on insurance and reinsurance assets and liabilities.

The technology needs to be carefully tailored to the insurance products, which require a hands-on approach to deployment that involves stakeholders throughout the enterprise. Moreover, it's not just a matter of capturing incremental data elements, but also ensuring that business practices are capable of evolving to improve underlying business results in an environment of increased scrutiny. This calls for a platform that supports ongoing transformation in line with evolving business needs.

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# Integrated, cross-functional approach

Modernization for accounting change requires an integrated approach from multiple functional and business areas within the organization.

- ▶ **It's not merely a finance and accounting project.** Even if the results are targeted for financial reporting, the scope of change goes way beyond what the CFO's office can undertake on its own.
- ▶ **It's not merely an actuarial project.** Even though actuaries are intimately involved in the valuation of insurance contracts, this calls for an industrialized process implemented within the business.
- ▶ **It's not merely a line-of-business project.** The frontline sales and support teams will need to react to knowledge about how products are evaluated and reported in financial results, which requires information provided from elsewhere in the organization.

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Accounting change calls for broad participation from each of these groups, to a degree that will likely represent new territory for functional areas that have typically run as silos.

Insurers must not make the mistake of treating accounting change as something that can be solved by any one group – nor should they allow one silo to have too much control over the outcome to the detriment of others. This typically occurs when organizations take a reactive approach to the regulation that fails to consider the broader implications.

An integrated approach includes data and talent from throughout the organization, forming the basis for a strategic transformative response that recognizes the extent of the challenge and the stakes of the impending transformation of the industry.

## **Modernization for accounting change involves the following operational changes:**

- ▶ **New processes supported by modern technology architecture to connect frontline, actuarial and accounting systems with each line of business**
- ▶ **Business rules embedded throughout operations to ensure that the necessary information is being captured at a sufficient level of detail**
- ▶ **Stronger oversight of business activities with respect to their impact on financial results, with measures to ensure that frontline functions are taking the optimal actions to improve outcomes in terms of positive cash flow and operational efficiency**

**The result will be a converged operating model that brings together finance, risk and actuarial within a modernized IT architecture that delivers timely information to management and lines of business throughout the organization.**

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# Building the business case for modernization

Although modernization will necessarily involve a partnership with the chief information officer and participation of several other organizational stakeholders, actuaries and accountants have been first to understand the magnitude and implications of accounting change. Accordingly, it will be incumbent upon finance and actuarial teams to create a business case that achieves a shared benefit by working together with executive leadership throughout the organization.

That business case should be based on the incremental value of improved insights to the business, described in ways that are meaningful to the management of specific business units and functions. For example, improved estimates of expected profitability would yield better decisions on when and where to expand, and on how to allocate resources in customer acquisition or retention. Modernized systems with more scalable, effective and efficient end-to-end processes will generate a wide range of actionable insights, and the role of finance and actuarial teams will be to communicate the value of those insights to the rest of the business. The best way to build confidence in the business case will be to demonstrate “quick wins.” By generating cost savings with limited-scope process changes, organizations can support the business case for a larger-scale investment into a modernized operating model.

By having **finance, risk and actuarial functions operating together** in a converged operating model underpinned by modern technology, companies may achieve benefits in:

- ▶ **Lower operating costs.** Deployment of a cloud-based solution will lead to direct reductions in capital expenditure with potential for operational expenditure reductions as well.
- ▶ **Relevant financials.** The ability to provide complete, relevant, insightful and timely information about the measurement and movements in insurance and reinsurance assets and liabilities to both internal and external stakeholders will be a competitive advantage for insurers that get it right.
- ▶ **Better decision-making.** Better understanding of the financial results will lead to better decision-making. Management will be more prepared to take timely action on unprofitable or uncompetitive products.
- ▶ **Future-proofing for industry changes.** In the years following accounting change, there will be inevitable changes in industry structure. Even if it's too soon to predict exactly how the marketplace dynamics will play out, investing now in a converged operating model supported by a well-architected technology platform will preserve agility and flexibility for the future.

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# Critical success factors

Insurers developing their business cases and transformation strategies have identified the following critical success factors for modernizing in response to accounting change:

- ▶ **Implementation will require an “agile” approach.** If design decisions made early in the process are too rigid, there’s a greater chance that major midcourse corrections will be required once you fully grasp the extent of the business requirements.
- ▶ **Involve everyone early on.** Actuaries may consider one set of solutions, while accountants may consider another. This involves not only actuarial and accounting, but also operations and frontline staff – so include everyone throughout the process, with the expectation that you’ll learn as you go.
- ▶ **Assess your current competencies.** Some companies are excellent at liability valuation, while others excel at financial planning and forecasting. Knowing your company’s strengths and areas for improvement will affect your choice of solutions.
- ▶ **Make decisions after you understand the implications.** Understand the impact on operations and financial reporting and the cultural ramifications, and then compromise on the best approach.
- ▶ **Build upon a solid technology infrastructure.** Look for a cloud-based platform with API-based connectivity, business rules that can be embedded directly into frontline operations and a user-friendly interface that allows business users to customize rules to their evolving needs without needing to bring in programmers. These capabilities have been proven to be essential for a modernized technology infrastructure.
- ▶ **Don’t delay.** Given the industry-changing implications of accounting change, firms need to act now to transform investor perceptions, realign executive incentives and redefine how they operate.

By acting quickly with an understanding of the urgency for modernization, insurers will be positioned to thrive with an operating model that delivers the flexibility to respond to changing investor and stakeholder perceptions brought about by accounting change.

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