LESSONS LEARNED FROM IMPLEMENTING COMPLEX FINANCE & RISK CHANGES

PRACTICAL LEARNING POINTS FROM IFRS 9/ IFRS 17

Authors: Youri Pasternak, Auke Jan Hulsker, Rob Bieshaar
April 2020

Summary

Implementing complex finance and risk changes such as IFRS 9 or IFRS 17 in a timely and effective manner has been challenging for many financial institutions.

This whitepaper includes three key lessons learned as well as practical tips and tricks for implementing complex finance and risk changes, based on our experiences with IFRS 9 and IFRS 17 at various banks and insurance companies in the Netherlands.

1) **Key lesson 1.** Implement the value chain as a whole instead of in silos. Complex changes like IFRS 9 and 17 impact many systems in the insurance contracts and investments value chains, from source systems, to calculation engines to consolidation and reporting. To successfully implement the value chain as a whole it is essential the different (sub)projects work together closely. Implementing new requirement(s) as much as possible into existing value chain can results in overall better quality and more efficiency.
2) **Key lesson 2.** Define the minimum viable product and prioritize compliance above other scope items. Complex, unclear and changing requirements for customizations in combination with too high project ambitions increase the risk not delivering the minimal viable product (compliance) and budget overruns.
3) **Key lesson 3.** Involve the first and second line from the start of the project into the change organization results in better quality, smoother implementation, better knowledge transfer, less aftercare and lower cost. For IFRS 9 specifically work closely with the front office (SPPI test), Risk (Impairment models) and ORM (control framework).

For many years financial institutions have faced changing regulatory reporting requirements. These requirements have often been complex and challenging to implement in a timely and efficient manner.

This white paper describes some of the key challenges financial institutions face during implementation and provides practical suggestions based on our experiences with IFRS 9 (Banks) and IFRS 17 (Insurance companies).

Key lesson 1. Implement complex changes within the value chain and implement the value chain as a whole instead of in silos

Challenges

Complex changes like IFRS 9 and 17 impact many systems in the insurance and investments value chain from source systems, to calculation engines to consolidation and reporting.

The different projects are often managed in silos resulting in misalignment in both content and planning. Decisions made on the level of granularity in the CSM engine for instance impact the set-up of the risk-engines and datawarehouse. The risk-engines can only finalize their models and start preparing their interfaces as soon as the data requirements from the accounting hub and CSM engine are finalized.

Another key challenge is how to ensure the source data can be delivered timely and according to dataquality standards to meet reporting requirements at the end of the value stream. When working in silos, there is the risk of misalignment between the teams responsible to define the actual chain delivery (Balance sheet, P&L and disclosures in accordance to IFRS 17/9) and the source systems responsible to deliver the data.

It is a true challenge to keep overview on the value chain as a whole and manage inter dependencies.

Practical tips

- Assign one or more coordinators who oversee the value chain of a whole (together). For example, a coordinator for reporting of the balance sheet/P&L and disclosure for IFRS 17 and one for IFRS 9 delivery. The coordinators need to have expertise in the area he or she oversees and work together closely because of the interdependencies between IFRS 9 and 17. The coordinators will work closely together with project and programme managers to support in aligning the different project plans and ensure achieving the minimal viable product.
- Create a list of interdependencies between the different projects. Architectural designs (maps) of the end-to-end dataflows can be of help
- Resolving misalignments between the different projects is going to lead to discussions. Set-up project governance with active involvement by senior management to ensure quick decision making
- Start soon with executing (fully sourced) chain tests. Chain tests will provide very useful information on inter dependencies and possible in discrepancies

Key lesson 2. Define the minimum viable product, prioritize compliance and assign product owners from the business.

Challenges

As opposed to Solvency II, IFRS is principles based. As a consequence, a very large number of technical decisions need to be made on how to apply the IFRS standards. Technical decisions often result in highly complex requirements like specific methodologies for amortizing loss component or how to account for capitalizing acquisition costs and disclosing revenues and expenses. Requirements for organization specific complex customizations often change and the impact to implement these is hard to estimate upfront.

Some financial institutions make use of the momentum to incorporate other changes in the scope like optimizing finance and risk processes and tooling as well as target operating model redesign. Such “optimization” changes might also be needed in order to become and remain compliant in the long run. On the flip side of the coin, the scope may become too big, resulting in a risk the minimal viable product (IFRS 17/9 compliance) may not be achieved in time.

Too high ambitions in combination with underestimation of the amount of work may lead to unrealistic project plans, budget overruns and project deadlines not met.

How, in such a context, timely implement requirements and accomplish project deadlines?

Practical tips

- Define and specify the minimum viable product for the dry-runs and deliverables
- Assign one or multiple product owners with in-depth finance and risk knowledge and mandate to prioritize and monitor the projects and deliverables
- Prioritize compliance scope-items above other scope-items like management information
- Become in control over your project by:

- assigning clear roles and responsibilities with segregation between requirements, configuration and user acceptance testing teams
- specifying requirements and freezing requirements and specifications after hand-over to configuration
- effectively applying an Agile way of working[1]

Key lesson 3. Actively involve the first and second line into the change organization

Challenges

Although financial institutions have many experts within their own organization, large scale regulatory change projects are too often managed and run by too many (external) consultants.

There are examples where SPPI tests are designed by external consultants using the most comprehensive checklist , which is then executed by external finance consultants, lacking in-depth knowledge of the specific prospectuses/investment contracts. As a consequence, the execution and implementation of the SPPI test becomes an expensive and inefficient process.

Another example from IFRS 9 implementations is underestimation of the impairments models. Although the probability of default (PD) is already at hand in most cases (for Solvency II purposes), the calculation for IFRS 9 differs from the calculation for Solvency II. IFRS 9 requires forward looking, point in time PD's, which need extensive (usually difficult to obtain) market data, models and tooling. Postponing in-depth impairments investigation and design to the last phase of the project, can pose a significant (project) risk resulting in non-compliancy with IFRS 9 and/ or questions from auditors. Especially investment grade, government bonds, portfolio are the trickiest ones, as almost no default data is available for government bonds.

Lastly, and often postponed to the very end, complex finance and risk changes usually require updates in the control framework. (External) consultants tend to develop new control frameworks, write new processes and controls based on a generic framework. How to update the framework and implement effective controls that align with the specific processes, products and risks of the company?

And overall, how to make use of the extensive knowledge within your company for the benefit of these complex finance and risk changes?

Practical tips

- From the start of the IFRS 9 project make sure to involve the front office in the SPPI test. Think about automated tooling for listed securities and design simplified manual tooling. Tailor to your portfolio, it will save a lot of time and budget later on in the project.
- Do not underestimate the IFRS 9 impact for insurance companies, and especially the impairments. Although the materiality might be low, the process and operational impact is likely going to be significant. Make sure to involve Risk and Operations from the beginning instead of keeping the IFRS 9 project (too long) Finance only.
- Start the design of IFRS 9 impairment models as soon as possible with your Risk department and involve the auditor in your assumptions to ensure your practical expedients are acceptable and compliant with IFRS.
- Onboard ORM (internal) experts to your project teams, so process designs and control framework updates are part of your incremental deliveries. Try to implement small

[1] Refer to article "How to effectively apply an Agile way of working within Finance and Risk" Durk Steegenga, Auke Jan Hulsker April 2020

parts of the project in the business as usual during the project.

- Involve internal people from the finance and risk business as usual (full value chain, not only accounting and reporting) in the project delivery and later on parallel runs

Youri Pasternak is a chartered accountant with over 15 years of experience in the financial services industry. 8 years of which as an auditor of large international financial institutions and 7 years as a business consultant acting as chain coordinator, product owner, projectmanager and/or advisor to senior management in change projects within finance, risk, and operations. Using his extensive experience, Youri often acts as sparring partner for senior management.

Auke Jan Hulsker supports insurance companies in becoming compliant with complex regulations such as IFRS 17. Auke Jan has specialized in implementing finance and risk accounting and reporting systems. Using his combined in-depth knowledge of regulations such as IFRS 17 and experience with system implementations, Auke Jan bridges the gap between Finance, Risk and IT. Auke Jan is the founder of Sofia Consulting and publishes on a frequent basis on the challenges finance and risk face these days including practical tips and tricks.

Rob Bieshaar has operated in the regulatory and enterprise performance management market for over 30 years. First gaining experience as a controller, Rob soon saw the benefits of software and consulting solutions for finance and risk. Rob nowadays is a highly respected lead consultant and as a business partner Rob is putting customer and quality first. Rob Bieshaar is partner of Sofia Consulting and responsible for business development.

Sofia Consulting is a network of freelance experts specialized in finance and risk for financial institutions. Within the Sofia Consulting network contractors share knowledge and develop practical solutions for the generic challenges finance and risk face. By organizing knowledge sessions and through project- and interim assignments via Sofia Consulting knowledge is transferred to banks and insurance companies.

www.sofia-consulting.com