



# Regulation overload sparks IT re-think

Reactions in association with BNY Mellon Asset Servicing held a roundtable in New York to discuss how the various regulatory initiatives globally are affecting insurance firm's technology demands.

**Michael Loney: How much are the various regulatory changes in the insurance industry affecting insurance companies' views on outsourcing technology as opposed to building internally?**

**Peter Keaveney, BNY Mellon Asset Servicing:** We are seeing firms who are saying they see some value in the services that are offered from firms like ourselves in conjunction with a technology solution. They might feel that there is something in the marketplace from a technology standpoint that meets their needs but they don't want to have the operating overhead cost associated with that.

It's a mix right now. The bigger firms are probably looking at a technology and operation solution whereas the medium and smaller size firms are looking for one-stop shopping where you can give them the technology solution along with the operation solution. That is the dynamic that we're seeing.

One of the biggest changes is on the regulatory accounting side. If you looked three or four years ago that was considered sacrosanct by insurance companies. Now, they're actually willing to talk about outsourcing that to providers like ourselves.

**Michael Loney: You mean sacrosanct as in they thought they could handle it themselves?**

**Peter Keaveney, BNY Mellon Asset Servicing:** Yes. They would say: "We will do this. It's core to our operation, we don't want anybody else having the keys to the kingdom." Now we're seeing firms that are saying: "We see value in outsourcing that to a provider like yourselves: you have economies of scale, better technology, and newer technology." And with the regulatory issues of the day they'd rather focus on finding solutions around that as opposed to worrying about the day-to-day statutory accounting requirements.

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**Jason Knight, BNY Mellon Asset Servicing:** The regulatory changes that have occurred or are being anticipated in the future are forcing insurance companies to review and rethink how they do things internally. The demands that are being forced on the back and middle office operations of insurance companies are increasing. In addition, the overall economic and investment environment over the past five years has forced insurance companies to analyse their overall operating costs as they look to offset some of the performance challenges with their investment portfolios and impact of underwriting results. As they do that and begin to analyse things such as systems and internal resources associated with investment accounting and analytics, there's significant expense associated with retooling the technology side as well as keeping their staff trained and able to handle the regulatory changes that are occurring.

The other impact is that technology and the operations teams are dealing with increasingly complex portfolios, which require a greater skillset from a valuation, analytics and performance measurement perspective.

**John Lehner, Eagle Investment Systems:** I would take a different angle on it, more from a technology standpoint. There have been transitional periods between technologies, whether it was mainframe to client server, or client server to PC to web. Clearly, there is another transition occurring now with the evolution of cloud and distributed capabilities. It hasn't been fully defined yet but people are reluctant to invest in legacy infrastructure, data centre operations and technology professionals when they see the possibility of something coming closer and closer in terms of a cloud or ASP or SaaS-based delivery models. So while the regulatory pressure has never been greater, you also have this reluctance to say what the next stable platform is for the CTO and the CIO. We already see that decision being made – it's just a matter of how it manifests itself in this industry. You already see it in web services and other industries. It's a question of how secure it needs to be, who the players are going to be, what the economic model is going to be and who's going to control that. That's a huge area because it aligns directly with what Jason and Peter said around the regulatory side. The business pressure is intense, yet underneath that you're not quite sure where you're going to end up in terms of a platform or a deployment strategy. That's a huge pressure, then combine it with the cost and all the other items.

**Michael Loney, Derek, what is the insurer's viewpoint?**

**Derek Pratt:** We've been in a soft insurance market for an extended period of time. What's available in the market isn't generating the yields that we were so accustomed to just a few years back. So it's an incredibly challenging time right now. You're stuck between a rock and a hard place. In the insurance business we're all here to support the underwriters, make them successful and make sure that we're protecting the assets that the folks are putting in and generating return on it. In this environment it's been really, really hard to do that, so we have to look at cost and whether we are doing things as efficiently as possible. Are we giving the decision makers the information they need to go out there and find the investments that are going to outperform and make us generate a little bit better return out there? Do we have the tools to make sure that we're matching up the assets with those liabilities correctly so that we're not putting ourselves at further risk of stretching for that little bit of return? There are a lot of different variables in play right now. It's an exciting time but it's also a very hard time too.

**Doug Welch, Deloitte:** It's the confluence of all these factors. You start with the low-yield environment. We've seen expense pressure starting on the insurance side, and working its way into



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the investment organisations. Meanwhile we've got all these regulatory challenges that are increasing. What we see in the short term is many companies just try to deal with that offline – pulling information off systems and dealing with it in Excel or similar tools. That's their short-term solution, and it almost gives them an illusion they can handle it for a period of time. But ultimately they have to make the transitions. If they look at it on a year-to-year basis the outsourcing may not look as attractive. But if they look at it over the long-time horizon, having a partner that can help them get there on their own is a big deal to most organisations.

**Michael Loney: So are you seeing people willing to tackle the big spending that they'll need to do?**

**Doug Welch, Deloitte:** There are a number that are doing that now, and it's on the table in other firms. The leadership in the investment group at times gets frustrated that spending on core accounting and reporting solutions consumes a good deal of what they can spend investment-wise both from a business process and technology point of view. But certainly there are companies that are willing to do it – they see that as a cost of doing business. It's an inflection point for everybody, a chance to go out and say: “Is there a partner or set of partners that we can work with that may not completely avoid the large cost at this time but at least better position us for the next hurdles that will come up?”

**Matthew Johnson, KPMG:** The key thing is the transparency. There's a lot more need for transparency to understand the risks that are being taken for the return generated. When you combine that with a vast legacy environment, what is needed is common data, a common reporting platform and capabilities. How do you get there? It's the underlying technology. But the mandate clearly is increased transparency, which requires better reporting and measurement about the risks taken, the money received for taking that risk, and the returns generated. That's the business mandate. Then you layer onto that the regulatory mandates, in terms of transparency and in terms of audit-ability, it's a lot of change happening very quickly and the technology investment required is pretty significant for many organisations.

**Michael Loney: So firms already have the legacy problems that have existed for years and now the extra regulatory pressure is making things worse?**

**Doug Welch, Deloitte:** A number of years ago regulatory reporting



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other than statutory was largely mapped through the ledger, and the ledger was controlled. Then as the SEC has been pushing for more transparency around unrealised losses, suddenly other data stores become critical to the business. It’s not just about what other industries view as the traditional data warehouse, it is also about what supports the financial reporting. That ups the game completely in those areas and puts pressure back on the organisation.

**Peter Keaveney, BNY Mellon Asset Servicing:** If you’re going to be a solution provider today in this space, data is the key. You’ve got to be able to give real-time accurate information to your partners if they’re going to be successful and you’re going to be successful. If you can’t do that, that’s absolutely the big dividing line between those who are going to survive in this business and those who aren’t.

We look at it as a solution continuum. A lot of people started out with just the technology solution, and then they went to a hosted solution where they didn’t have to worry about the upgrades. Now we’re seeing what we’re calling co-sourcing where firms are saying: “Okay, you have the technology, you host it for me, and you give us some services.” Specifically around the data management side and the regulatory arena, people are looking at performance measurement and key operating areas for them that they haven’t been able to tackle effectively. They want a solution with a provider well in advance of moving to a full outsource. You’ll see that full spectrum come into play, especially in this space, more so than probably even the investment management space. The insurance space is representing that very strongly right now, and I think that’ll continue to evolve in the next two years.

**John Lehner, Eagle Investment Systems:** It’s really hard. The mistake that firms sometimes make is to just jump into technology or just jump into outsourcing, and you can’t do that. You have to have somebody walk you through that transition and what it means to redesign your information flows and say: “What does it look like when we have a data centric model?” You basically have a different centre of the universe.

**Derek Pratt:** The transition can be difficult. You need to have that vision in mind.

**John Lehner, Eagle Investment Systems:** Somebody needs to own that vision. It’s tough now but we’re going to get to this better place. With all these challenges converging at the same time, there’s limited time, and focus is so key to be successful when you have all of these different things going on. So as an investment shop within an insurance company what do you want to do? What is

your advantage? Is it really doing upgrades? Is it really running the numbers to generate your performance returns? Or is it finding the best assets to match up with your liabilities that will make you reach your risk profile? Every firm has got to answer that question.

**Michael Loney:** Let’s talk about some of the specific regulatory changes that have gone on. The Dodd-Frank Act wasn’t as bad for insurers as certainly it looked like it could have been at one point, but how is it affecting the demand side of things?

**Jason Knight, BNY Mellon Asset Servicing:** The initial impact on insurance companies has been relatively minimal. I think it’s the future regulatory changes or demands yet to be implemented that could be more impactful. For example, as you look at things like the establishment of the Federal Insurance Office and its focus on collecting and analysing data in determining which firms are deemed to be significantly important non-bank financial institutions, you have to be concerned about what additional demands are going to be placed on companies from a transparency or risk reporting perspective, looking at concentration risks, etc. So, while the initial impact was not dramatic, I think anticipation of the things to come are forcing insurance companies to look at their processes and infrastructure in order to prepare for the future.

**Peter Keaveney, BNY Mellon Asset Servicing:** It’s going to be three to five years down the road when it’s going to be more impactful to the insurance industry. Dodd-Frank was more weighted to the banking side upfront. It will slowly but surely make its way through the whole financial services industry. It’s just a question of when.

**Michael Loney:** Is there a sense that firms are more in fire-fighting mode rather than being able to get on the front foot, because of all the regulatory demands in place?

**Doug Welch, Deloitte:** I don’t know if I’d describe it as fire fighting because it’s not that reactive. There are a number of firms being proactive, but I do think that there’s too much focus on solving specific issues as opposed to stepping back and looking comprehensively. For example, at the heart of Solvency II while there are a lot of questions outstanding on equivalency and transitions it will likely involve modelling of securities and cash flows in different economic scenarios. That’s very similar to what we do in valuations, and very similar to what we do in an ALM modelling. So if you step back and look at it more holistically it’s about having those capabilities for a combination of purposes. We



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all recognise investments are all about cash flows, and cash flows in different scenarios. Rather than solving those as specific items how do you step back and handle multiple frameworks within a common capability? So I wouldn't describe it as reactive, but on the other hand there's certainly more room to be even more proactive.

**Matthew Johnson, KPMG:** And we're seeing the disciplines come together between finance, accounting, IT, a lot of the actuarial practices and functions, as well as risk. It's providing different perspectives trying to figure out what do they need to meet all these different mandates. There's something in it for everyone if they all contribute and can get to a common data platform to get the information. One of the things we've seen as well, as we look to this transition, is a lot of the regulatory burdens have some common requirements related to documentation, the ability to understand and report, and the ability to take ownership and accountability so that people understand what they are generating, whether they own it, and whether they are running the business based on the numbers they're generating. That is driving some common reporting processes.

So there's a lot of commonality in the foundational requirements and as companies begin to understand that, they're going to find some synergies toward meeting a lot of different mandates.

**Michael Loney: So are technology vendors seeing more demand from insurance companies?**

**Jason Knight, BNY Mellon Asset Servicing:** Insurance companies have considered their investment back and middle office services, including investment accounting and performance and analytics to be core to their business. However, the events over the past few years have definitely led insurance companies to rethink that position. Historically, Insurance companies in addition to performing a lot of functions in-house have also developed and maintained proprietary technology or hosted third-party systems historically. Given the expense associated with continually adapting and changing these systems, to the extent that they can turn to partners to help them with those challenges, they're finding that to be efficient and beneficial for them.

**Peter Keaveney, BNY Mellon Asset Servicing:** I would add that what we're hearing is, especially from the middle office standpoint, a lot of the firms want to get to what we call a best practices model. They've integrated a number of organisations in their middle office and they have these varied operating environments and they're saying: "You know what? We can't continue to operate in this manner and operate almost three different middle offices, we want to consolidate that down to one and come to a best practices model."

**Michael Loney: Has technology on the accounting side been neglected traditionally?**

**John Lehner, Eagle Investment Systems:** Accounting, while we love it, doesn't get a lot of people excited as a commodity, let's face it, right? Over the last 15 years the budgets have gone to client portals, risk dashboards and other technology. If you were to look at a technology diagram of a typical insurance firm, the application that is probably the longest in the tooth is the accounting system. People just bypassed it, they put wrappers around it, they put technology around it. They did a lot to extend the life of that for as long as they possibly could because there's no glory in doing an accounting conversion. Most people look at it like a heart transplant—you don't do it until you're really desperate and ready to fall over. People operate under an illusion that they



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have it under control, and more often than not there's a lot of stuff off to the side that wouldn't pass the Sarbanes-Oxley test, never mind all these other types of developments. So people are doing it out of need, rather than wanting to do it. It doesn't necessarily bring in more policies or more subscribers or sell more products, but you will go to jail if you get it wrong, so you have to have it. And from a risk and due diligence standpoint the bar is much higher, so they're doing it because they have a gun to their heads.

**Michael Loney: How old is some of this technology people are using?**

**John Lehner, Eagle Investment Systems:** Most people look at technology from the top down, starting with the client. The newest technology is usually in front of the client. The front office end usually gets all the glitz with the risk dashboards in front of the compliance and CFO-type person. That's usually the most current state of the art system. It's also one of the easiest layers to implement. Those layers underneath are anywhere from 15 to 25 years old, and there's nothing else in the organisation that's half that old. People are finally realising this is holding them back. The weakest link is the accounting process, and so they have to do it. The cost is the driver. There's no money. The tide has gone out, and people see all the garbage that's been buried underneath there for a long time because they can't afford it anymore. The convergence of that with the regulatory technology couldn't come at a better time because the sense of urgency is real. This is going to run for quite a period of time.

**Peter Keaveney, BNY Mellon Asset Servicing:** The question is do you have that risk appetite anymore within your organisation to not make a change? That's spurring a lot of the people to look at it.

Economically a couple of years ago everybody was doing well so there wasn't the need. Nobody was saying: "Okay, you've got to figure out how to take your patchwork and upgrade your technology." Things were good.

**Derek Pratt:** You touched on a point too that I think showed some opportunity for the future as well. Some of the providers of the technology are now also looking for the solutions around that to perform the accounting functions for clients as people outsource more of these roles. I am excited to see what they'll do with that technology: will they be participating in forums where new rules are being made so that they are ahead of what's changing in the marketplace rather than waiting for a client to put another enhancement on the spot? Will that then create even more momentum to get these tools sharper to where it would be more compelling for clients to go through the burn and the pain of a lift out and a big conversion? That's an opportunity for some of the folks that are combining both technology and services around it.



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**Matthew Johnson, KPMG:** What has to be front and centre is that the tool ultimately is not going to give the answer; it's going to help support the implementation of the solution. The risk from a company's perspective is that they say: "Let's stay on the sidelines, let's not spend the money, let's allow the tool evolve to a certain degree then we'll just put it in, problem solved," whether it's convergence or whether it's any other kind of regulatory reform. The fundamental questions still have to be answered. Who do we want to be? What do we want to be? What kinds of risk do we want to take on? How are we going to measure and report that?

It will be interesting to see as companies begin to look at the evolution and the capabilities of the tool, as well as the outsourcing options, whether they are still going to come back to that discipline of asking the strategic and fundamental questions and getting those answered first and then looking out and saying: "Okay, now how are we going to get there? What's the most efficient way for us to get there?"

**Michael Loney: How much then have the technologies that are available improved in recent times?**

**Peter Keaveney, BNY Mellon Asset Servicing:** They've improved significantly. There's still room for improvement, but I think if you look at where the technology base was in this space three or four years ago versus where it is today, it's made some significant gains. The key is not just the accounting but marrying the accounting information together with the data management solution, with a data repository, and being able to give that full spectrum solution to the insurance companies. It's become easier to implement as opposed to several years ago where you had to get components from different providers and you couldn't put it all together seamlessly. That's where I've kind of seen the biggest jump.

**John Lehner, Eagle Investment Systems:** From your perspective, I understand that viewpoint. From an industry standpoint, though, I'm not that optimistic because the last several years were really tough. If the firms were not committing to their vision or strategy and not spending money that meant the vendors were not either. Most vendors' models are dependent on new business. That meant they were not getting new clients or other fees, which meant that they were cutting back on their R&D. We've all seen the numerous announcements of vendors consolidating – and there'll be a lot more of that. That's just getting started now and it will continue. As people are coming out of this, there are a lot of vendors that don't have anything in their tank because the first thing they cut other than firing the salesperson when there are no sales, is the R&D. It's not an early mover space so it doesn't attract the people that want to go to a Google or want to go to an Amazon Web Services. There's always been a challenge that you have great industry practitioners who understand the industry but



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it's a struggle for firms to attract and retain great technologists to partner with those business people. From our perspective we're very bullish, we like where we see it based on our position because we believe this presents an opportunity for any firm that has been continually investing and spending through good or bad to just keep ramping up and keep going forward. But there's definitely a shake-up due in the space. You're going to see more vendors exiting. Let's face it, there's no venture capital money coming into invest in accounting platforms, it's all going into biofuels and wind farms and that's where all the MBA students are going too.

Some difficult decisions need to be made for firms to understand what that means in terms of who they rely on and which providers are ones they can look to and what the standards are that they use to measure those providers. Who's in it for the long haul? Who has the money to invest? It's really hard to do. Most firms miss that turn early on and just go into cash flow mode and drive the business into the ground, some more rapidly than others. Some are very good at reinventing the business under a different model but at the end of the day it takes a lot of money and a lot of commitment to stay that course.

**Michael Loney: Derek, is there enough out there from the vendors to meet your needs?**

**Derek Pratt:** We are always having conversations with vendors, whether it's something that we're looking to do immediately or just trying to keep our finger on the pulse of what's going on. I definitely see what John is saying about some of the consolidation. Some of those vendors you knew just weren't investing in the product and now you can see that they're folding up the tents. Maybe some of that would be good for the industry, with some consolidation of fewer, better players.

We talk about how difficult it is to go through these conversions. I don't think you can be successful and sit on the sidelines for very long and not be courageous enough to say if something's broken we've got to fix it. There may be difficulty. It's a leap of faith, signing up with a new vendor for a core piece of your business, especially when it's something you used to do internally and now you're depending on another entity to perform that function for you. So you work hard and you're drafting solid SOAs and spending time together to transition that knowledge and put good thought and practice into making a decision and stand by it. But you have to keep evolving like the new security types or new reporting requirements. The world's going to keep evolving so either you're not going to keep up or you're just going to be whacking your head against a wall to try and keep up. ●

*\*Derek Pratt's views are his own, and do not represent the views of XL Group.*