LDTI: Key day one roadblocks that could derail your journey

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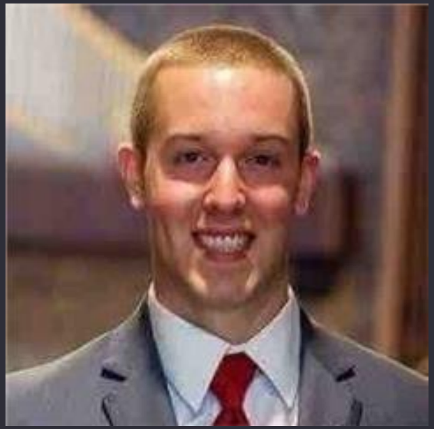
Today’s speakers



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Agenda

1. LDTI refresher and timeline
2. Key challenges and risks
    a. End-to-end testing and validation of key models, systems and processes
    b. Internal and external reporting
    d. Financial planning and forecasting
    e. Transition to business as usual (BAU) processes and controls
3. Risk mitigation techniques
4. Lessons learned
5. Q&A

Polling question 1

How familiar are you with the new standard (LDTI)?

A. Not very familiar

B. I know the basics, and I’m looking to further my understanding

C. I’m familiar with LDTI but don’t yet have a good feel for how it will impact our results

D. I have an in-depth understanding of LDTI and how it will impact our results

LDTI refresher

Accounting Standards Update (ASU) 2018-12, commonly referred to as *Long Duration Targeted Improvements (LDTI)*, amends existing US GAAP accounting requirements for long-duration contracts. A summary includes:

Area	FASB's intent	Product(s) impacted	Targeted improvements
Liability for future policyholder benefits (LFPB)	▸ Improve the timelines of recognizing changes in assumptions ▸ Modify the discount rate	Non-par traditional long-duration and limited payment contracts	• Requires cash flow assumptions and actual experience to be updated on a cumulative catch-up basis (i.e., retrospective); recognized through earnings • Requires discount rate assumption to be updated using the upper-medium-grade fixed-income instrument yield each period; recognized through other comprehensive income (OCI) • Eliminates loss recognition testing
Deferred acquisition costs (DAC)	▸ Simplify the methods to amortize DAC	All products except certain investment contracts	• Simplifies DAC amortization (a constant basis over the life of the contract) • Eliminates impairment testing
Market risk benefits (MRB)	▸ Simplify and improve accounting for certain market-based options or guarantees associated with deposit contracts	Deposit products with certain benefit features (e.g., variable annuities, fixed index annuities)	• Creates new classification for these features • Requires features to be measured at fair value with changes recognized in income (except for own-credit-spread effect)
Disclosures	▸ Improve the effectiveness of disclosures in interim and annual financial statements	All long-duration products	• Adds significant new granular disclosures • Adds disaggregated tabular reserve rollforwards • Adds qualitative disclosures about significant inputs, judgments and assumptions

In addition to the above, there are indirect impacts to certain other concepts in ASC 944, such as the accounting for reinsurance.

LDTI timeline

LDTI will become effective on January 1, 2023, for most public companies and on January 1, 2025, for most nonpublic companies. In response to this sweeping change in accounting framework, companies have been hard at work drafting accounting policy papers, updating actuarial models/data environments/ledgers, designing enhanced disclosures, and educating management to help ensure "go-live" readiness. A summary of the timeline is presented below:

	2021	2022	2023	2024	2025	2026
Early adopters	**Transition date** Comparative reporting periods for 2022 financial statements	**Effective date** First interim and annual financial statements				
SEC filers	**Transition date** Comparative reporting periods for 2023 financial statements		**Effective date** First interim and annual financial statements			
All other entities			**Transition date** Comparative reporting periods for 2025 financial statements		**Effective date** First annual financial statements	First interim financial statements

Polling question 2

What type of organization are you associated with?

A. Public company without US GAAP reporting

B. Private or mutual/fraternal with US GAAP reporting

C. Private or mutual/fraternal without US GAAP reporting

D. Other or N/A

Introduction: key challenges and risks

As the LDTI go-live date for public insurers draws near, companies are wrapping up their core implementation activities and shifting gears to focus on day one readiness and potential roadblocks associated with adoption. This discussion will highlight key operational areas impacted by LDTI and associated challenges, risks and risk mitigation leading practices.

1. End-to-end testing and validation of key models, systems and processes
2. Internal and external reporting
3. Financial planning and forecasting
4. Transition to business as usual (BAU) processes and controls

Key challenge No. 1: end-to-end testing and validation

LDTI brings unique challenges to preparing the end-to-end financial reporting process for LDTI go-live. Below, we've highlighted four key areas that may significantly stress organizations:

Area	Challenges	Risks
Data	• Increased focus on the retrieval and storage of historical data, along with how it will be maintained. • Capturing and transforming model output for use in internal and external financial reporting.	• Historical data may be incomplete or missing. • Overreliance on manual data transformations or inefficient processes. • Retrieving reports is time consuming and requires ad hoc preparation/analysis.
Actuarial	• Dependent on the level of system modernization — most actuarial models required some level of improvement to handle the requirements of LDTI. • Test strategy created to summarize the testing effort through systemic planning and techniques, including: unit/dev testing, component testing, end-to-end system integration testing, dry run and parallel runs.	• If company selects a minimum compliance mindset, initial savings on implementation costs could quickly evaporate due to high operating costs if systems are not well equipped to handle LDTI. • Not all models are tested with the same level of rigor, due to resource constraints. • Portion of testing strategy is expedited/overlooked (e.g., single-cell testing, nonfunctional tests), resulting in audit and process issues.
Finance	• Ledger/subledger journal postings to reflect new LDTI balances, income statement items, and disclosures. • Increased demands on financial systems/processes to properly reflect and reconcile ledger with new reports.	• Mappings from actuarial model output to ledger line item(s) and aggregation of the subledger(s) are incomplete/incorrect. • Ledger(s) are not fully integrated into end-to-end testing process. • Handoffs between finance/actuarial are never tested in a true "production" environment until go-live.

SOX controls	• Existing SOX controls must be extended/refreshed to provide coverage over LDTI models and any subsequent necessary changes in the financial reporting process.
	• New SOX controls may be required in cases where financial reporting processes underwent transformation.
		• SOX controls are not complete and/or robust, resulting in control failures such as:
		    • Decommissioned legacy GAAP processes continue to run
		    • Reported financial values are materially misstated
		    • Material weakness or significant deficiency resulting in penalties and reputation damage

Key challenge No. 2: reporting

Type	Challenges	Risks
Internal	• Update/enhance management reporting capabilities for GAAP and related non-GAAP measures (operating income) and key performance indicators (KPIs). • Deliver and explain new results and reporting to C-suite, board and audit committee.	• Data, new processes and MD&A may not be timely enough. • Actuarial and finance teams may not have the tools/resources/experience to analyze and communicate the story and underlying drivers. • Key stakeholders will need to get comfortable with results and provide signoff — must understand differences between current GAAP and LDTI (which vary significantly by product type).
External	• Q4 10K and updated SAB 74 disclosures (prior to go-live). • LDTI restatement financials. • LDTI quantitative and qualitative disclosures, including disaggregated rollforwards, SKFs, MD&A, financial supplements. • LDTI investor day (optional). • Internal and external audit.	• Financial statement preparation software (if applicable) may not be QA/UAT tested and/or capture all the necessary information. • Open accounting policy/methodology or audit issues may delay finalization. • Volatile market conditions. • Non-GAAP metrics may have changed. • Audit procedures may lag behind desired disclosure timeline; audit findings may require rework or changes. • Peer company disclosures or investors/analysts may put pressure on management to accelerate or expand the amount of information provided.

Public life insurer disclosures as of 2Q 2022 reporting

- About three-fourths of major public life insurers have released quantitative disclosures.
- Using current Single-A rates to calculate reserves for traditional products will reduce AOCI at transition for many companies, but the increase to Single-A rates since 1 January 2021 will lessen the impact to current balance sheets.
- Derecognition of shadow DAC adjustments (and related items) at transition will increase AOCI.
- MRB impacts at transition and overall impacts to earnings/operating income will vary by company.

Polling question 3

For public companies only, what are you most concerned about as the LDTI go-live date nears?

A. Accounting policy and methodology

B. Actuarial systems

C. Data management systems

D. Dry and parallel runs

E. Analysis of results

Key challenge No. 3: financial planning and forecasting

Challenges

- Integrate LDTI into financial planning and forecasting systems and processes.
  - Develop forecasting capabilities.
  - Define and agree on financial metrics/targets under LDTI.
  - Complete the FY23 financial plan and subsequent forecasts.
  - Align updated management reporting and planning/forecasting for LDTI.
- Respond to increased demands for sensitivity testing and “what-if” analyses.
  - Management’s need to understand the sensitivities and multiyear trends associated with LDTI.
  - Economic and capital market volatility.

Risks

- Projection capabilities for LDTI may not be fully completed or QA/UAT tested (data and/or resourced constraints).
- Forecasting cycle time may exceed targets.
- Key stakeholders may not be fully comfortable with LDTI restatement period and projected results.

Key challenge No. 4: transition to business as usual (BAU) processes and controls

Challenges

- LDTI production process will replace current GAAP process.
  - Running the LDTI process in parallel may not be in real time and/or reflect a production environment.
  - Valuation and reporting teams will need to perform double duty during parallel reporting period.
  - Actual LDTI close-process timing may not be known and/or align with the desired close calendar.
  - Transition from LDTI project to production teams.
  - Controls will need to be executed and tested live.
  - Real-time remediation needed due to increased risk of errors/process failures.
  - Decommissioning of processes replaced by LDTI.
  - 10Q to be produced under LDTI basis (including SKFs, MD&A, Fin Supp).

Risks

- Roles and responsibilities not fully defined and understood for LDTI go-live.
- BAU staff may not be prepared with knowledge and tools to identify key drivers.
- Data/system issues related to modeling/ledger environment change.
- Financial statement preparation software not fully tested/functional for go-live.
- System processing and modeling capacity (computing) may not be able to handle LDTI and other production processes concurrently.
- Certain inputs (e.g., pending claims, investment data) may not be available in time to meet accelerated GAAP close calendar.

Polling question 4

Which of these metrics will your company be focused on going forward?

A. Source of earnings analysis

B. Return on equity

C. Adjusted earnings/operating income

D. Free cash flow

E. Value of new business and/or embedded value

F. Other

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Recap of key challenges and risks

Challenges

1. Data, models, systems, and processes may **not be properly validated and tested.**
2. **Resources are constrained** and may not be fully prepared due to:
    a. Competing priorities (current GAAP, statutory, other)
    b. Inadequate training, change management and/or readiness planning
3. Transition from development/testing to a **production environment/mindset** may be difficult.
4. **Meeting current close calendar** and reporting timelines with new LDTI processes may be challenging in year of adoption.

Risks

1. Financial reporting may be **delayed** or results may **not be properly reported.**
2. Controls may **not satisfy SOX requirements** or company standards.
3. Internal/external stakeholders may not **understand the results** and/or know what to expect going forward.

Given these obstacles, what can you do to mitigate these risks?

1. Operational readiness risk assessment and planning
2. Robust and timely execution of audit (and audit support)
3. Resource augmentation (external support or internal realignment for delivery, remediation and/or backfill)
4. Rapid response team(s) and contingency planning for potential system/process failures or key person risks

Polling question 5

For private companies only, what stage of the LDTI roadmap best captures where your company is at currently?

A. High-level business impact assessment

B. Solution design and roadmapping

C. Component build and test (including policy, methodology, data requirements, model development and testing)

D. Integrated testing and controls

Looking forward: 6 things nonpublic companies can learn

1. Ensure program alignment and robust program governance for decision-making.
2. Define and articulate target LDTI implementation plan (modernization vs. compliance trade-off) with sufficient emphasis on testing, transition, controls and management reporting.
3. Comprehensive evaluation of data needs can aid in identifying gaps and streamline data gathering/storing.
4. Involve key internal stakeholders early and throughout the process to anticipate/respond to business needs and obtain buy-in.
5. Ensure sufficient time to train business as usual (BAU) resources and create documentation.
6. Stress-test enhanced financial close calendar during comparative run period.

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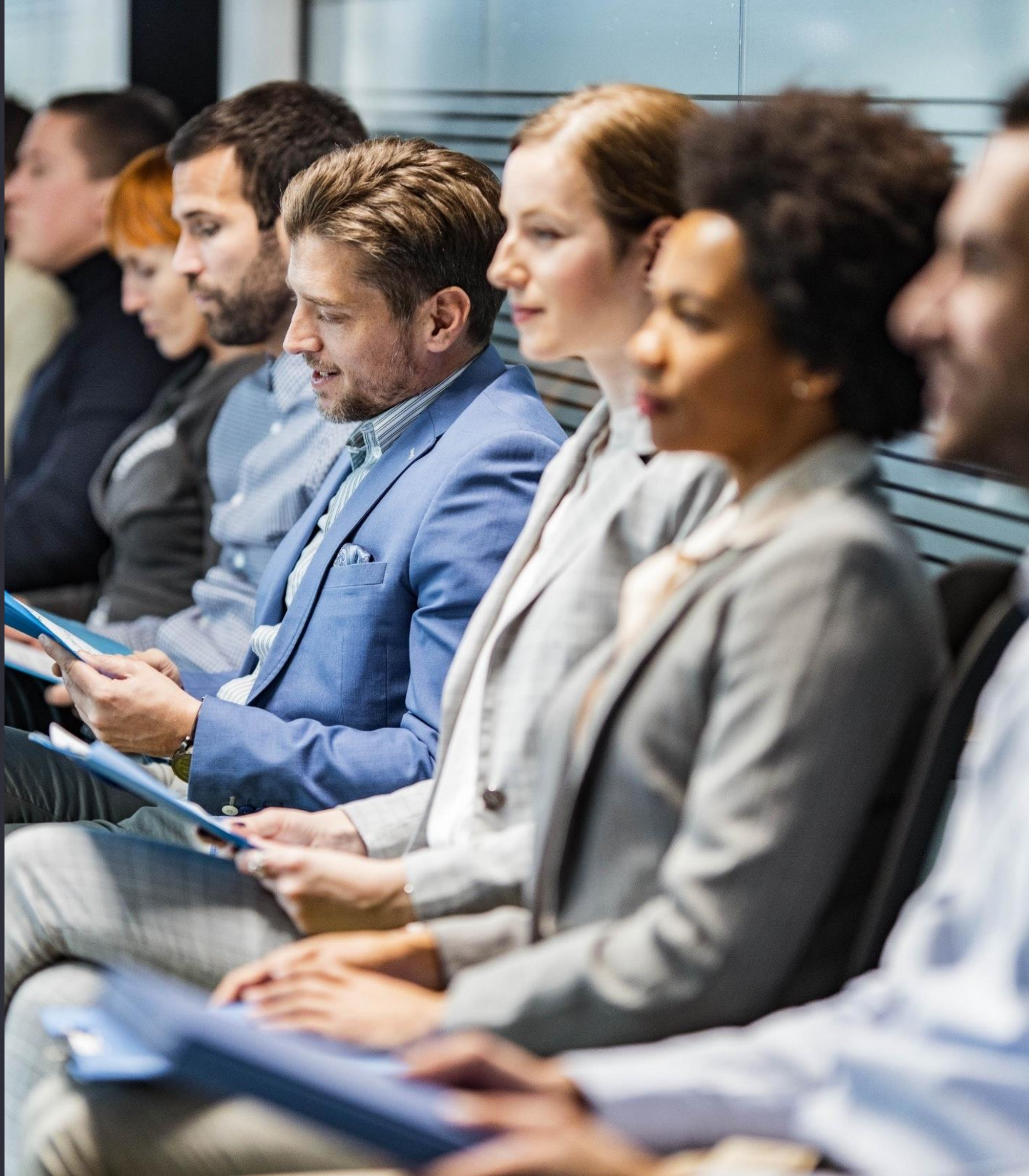
Questions?



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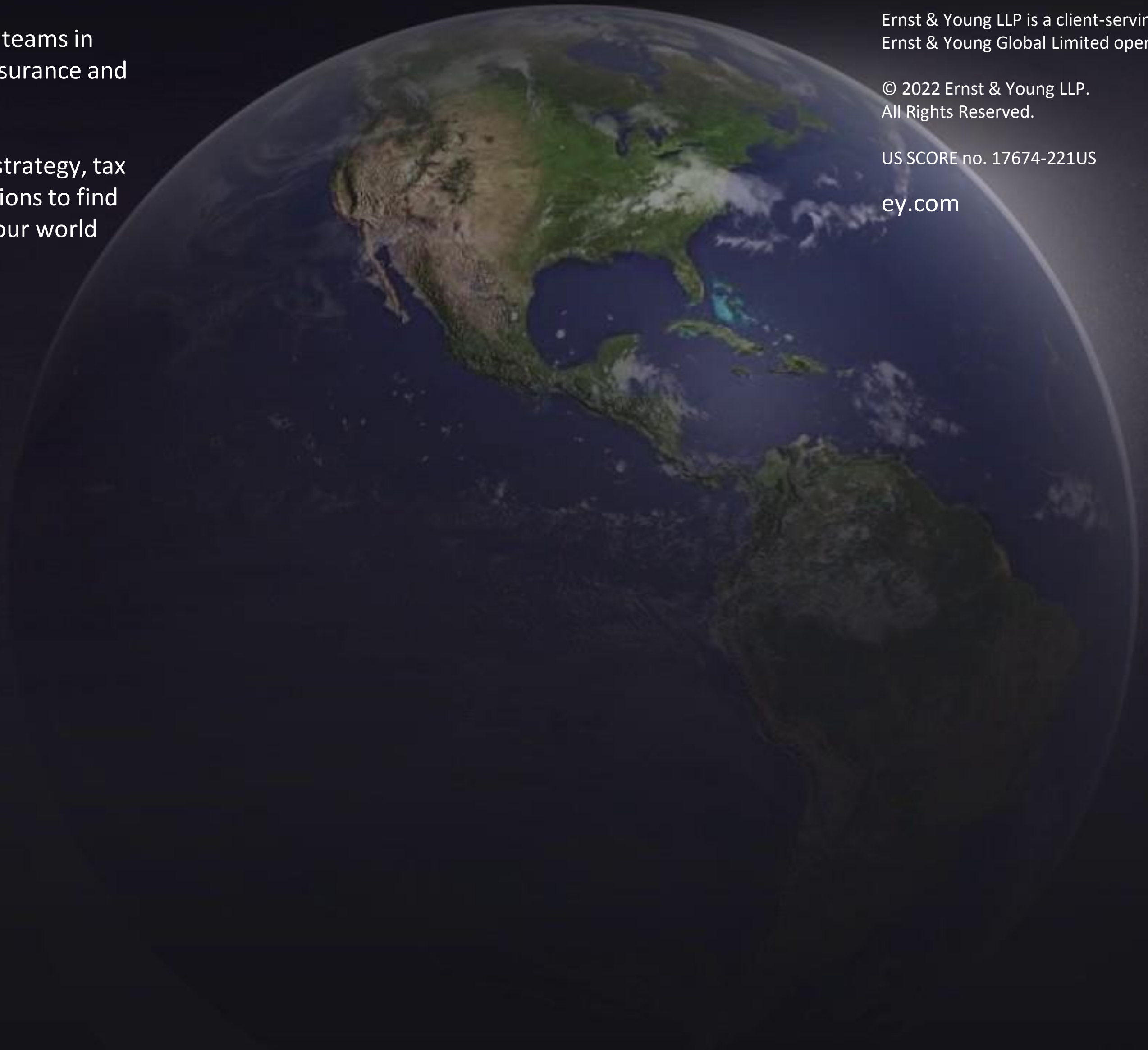

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