Tackling the ASU 2018-12 long duration targeted improvements new disclosures requirements: Future policy benefits rollforward

In August 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2018-12 (the ASU 2018-12), amending the accounting model under US GAAP for certain long duration insurance contracts and requiring insurers to provide additional disclosures in annual and interim reporting periods. The new disclosures clearly recognize the complexity involved in determining actuarial balances, the detailed cash flows, and assumptions that enter into the calculation. They are designed to provide additional transparency into the liability balances and reflect the nuances of insurance products as the complex financial products they are intended to be.

ASU 2018-12 introduces new and enhanced reporting requirements to allow "users to understand the amount, timing, and uncertainty of future cash flows arising from the [insurance] liabilities."[1] This article will focus on one of the complex disclosure requirements, the future policy benefits (FPB) rollforward. This disclosure will affect the enterprise process, governance, people, technology, and data requirements. There are elements of disaggregation that must be considered in the development of a line of business view, but our focus is on the mechanical aspects of the rollforward, and it is assumed that disaggregation has already been addressed in the discussion that follows. To achieve compliance with this disclosure requirement, insurers will need to evaluate numerous accounting policies, valuation procedures, and data management structure.

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Key enhancements for the future policy benefits rollforward

The requirements of ASU 2018-12 for the tabular rollforward for future policy benefits include the opening-to-closing balance and other quantitative and qualitative disclosures. The following key enhancements are required:

1. The tabular rollforward should separately present the expected future net premiums and expected future benefits.
2. The FPB rollforward should be accompanied by information about the undiscounted ending balances of expected future net premiums and benefits; gross premiums recorded; related reinsurance receivables; and quantitative and qualitative information on the significant inputs, judgments, techniques, and assumptions used in the measurement, including unobservable rates.
3. The FPB rollforward should be reconciled to (1) the liability balance in the statement of financial position and (2) the total interest and gross premiums recognized in the statement of operations.
4. An insurer needs to provide qualitative and quantitative information about (1) adverse development at the level of aggregation at which the reserves were calculated that resulted in a charge to benefit expense in the current period and (2) for contracts for which no liability was recognized, the significant inputs, judgments, and assumptions used to conclude that no future losses are expected.

This rollforward is a combination of financial and actuarial components. The best way to break down the components is to consider the balances related to existing in-force business with which the company begins the year and new business issued in the current fiscal year.

944-40-55-13l

The tabular rollforward of the beginning to the ending balance related to the liability for the future policy benefits or the additional liability as required in paragraph 944-40-50-6 could include the following line items:

a) Issuances
b) Interest accrual
c) Net premiums or assessments collected
d) Benefit payments
e) Derecognition (lapses or withdrawals)
f) Effect of actual variances from expected experience
g) Effect of changes in cash flow assumptions
h) Effect of changes in discount rate assumptions

Impact on insurance entities

For many companies, ASU 2018-12 will present a real reporting challenge with a substantial redesign of current reporting processes and the collection of data for transition and future reporting. Specifically, for the future policy benefit rollforward disclosure requirements, a company's processes, data manipulation and aggregation, technology, governance, and people will be affected as follows:

Process

- Update existing processes to address new data source feeds for the necessary level of granularity and to capture actual benefits and premiums.
- Address the order of processing so the valuation is completed in an orderly fashion to reduce circularity or unnecessary delays.
- Build a process that includes the accounting policy or actuarial method elections related to updating of the net premium ratio quarterly or annually.
- Change the financial reporting timeline, given the increased level of effort to calculate, perform review and analysis, and disclose the actuarial balances.
- Eliminate legacy processes appropriately, without dropping any necessary integration steps (e.g., assumption setting) or overextending the eliminations (shadow adjustments).

Data

- Include new and/or expanded financial data to allow reporting at the appropriate level of granularity, which will increase data volume.
- Identify the proper source of information that supports the actuarial methods and accounting policies after considering the available options.
- Adjust data and calculations to reflect the guidance and modify direct inputs into data source systems to enable ease of flow through actuarial systems, disclosures, and reconciliations.
- Harmonize valuation output from multiple actuarial systems, split between current in-force data, new issues data, claims data, and integration of new data sources.

The deployment of automation solutions to add tangible value to actuarial processes can be challenging. Governance in the form of accounting policies and actuarial methodologies are just a few areas that can benefit from automation. Deloitte's Exponential Actuary™ and Exponential Professional service offerings can assist in planning and/or executing these types of endeavors.

Technology

- Execute multiple valuation model runs to produce expected future net premiums and expected future benefits reflecting each attribution of change in cash flow assumptions.
- Expand run-time and storage capacity for the valuation model runs that will be used to create the future policy benefit rollforward disclosure.
- Migrate actuarial systems from mainframe and factor-based reserve calculations to a first-principles vendor solution, as these legacy calculation engines will not be able to produce information necessary without significant modification (or perhaps re-engineering) for this rollforward disclosure.

Governance

- Control the use of data, level of granularity, definitions, and metrics throughout the process flow and clearly document process flow narratives.
- Assess and modify internal controls across the entire process, with special focus on the migration and compression of data elements.
- Reconcile the future policy benefit liability in the statement of financial position to the total interest and gross premiums in the statement of operations.

People

- Increase actuarial and finance resources to address more frequent updating of best estimate assumptions, run actuarial models, and produce required disclosures with required qualitative and quantitative information.
- Integrate automation in order to eliminate human error and allow people to contribute to high-value work to optimize workforce productivity to the organization.

Demonstration of future policy benefits rollforward

The tabular rollforward of the beginning to the ending balance related to the liability for future policy benefits, which is required to be displayed on a year-to-date basis, could include the following line items, as displayed in ASU 2018-12 (example 3, section 944-40-55-29E): effect of changes in cash flow assumptions (see figure 1), effect of actual variances from expected experience (see figure 2), issuances and derecognition (see figure 3), capturing changes (see figure 4), and net liability for future policy benefits (see figure 5).

Companies should not underestimate the level of effort to compile the FPB rollforward. Voluminous data generated from numerous model runs will be required. Collaboration between finance, actuarial, and IT stakeholders should begin in the early stages of the implementation process.

The level of aggregation for the future policy benefit reserve rollforward disclosure is subjective. The fundamental principle for aggregation or disaggregation is "…aggregate or disaggregate the disclosures…so that useful information is not obscured by the inclusion of a large amount of insignificant detail or by the aggregation of items that have significantly different characteristics." Categories that might be an appropriate starting place for aggregation or disaggregation, such as type of coverage (product line), geography (country or region), or even the type of customer (group or individual), are mentioned, but an exhaustive list is not provided. For example, a public company may decide to calculate the reserve for future policy holder benefits at a much more granular level (20-year term life versus 30-year term life) and then aggregate to a higher level for disclosure purposes (e.g., term life). Many of these attribution items in the future policyholder benefits rollforward are explained in ASU 2018-12; however, there are a few line items that require special attention.

Figure 1. Effect of changes in cash flow assumptions

Rollforward for present value of expected net premiums
Balance, beginning of year
Beginning balance at original discount rate
– Effect of changes in cash flow assumptions
– Effect of actual variances from expected experience
Adjusted beginning of year balance
– Issuances
– Interest accrual
– Net premiums collected
– Derecognition (lapses)
Ending balance at original discount rate
– Effect of changes in discount rate assumptions
Balance, end of year

Rollforward for present value of expected future policy benefits
Balance, beginning of year
Beginning balance at original discount rate
– Effect of changes in cash flow assumptions
– Effect of actual variances from expected experience
Adjusted beginning of year balance
– Issuances
– Interest accrual
– Benefit payments
– Derecognition (lapses)
Ending balance at original discount rate
– Effect of changes in discount rate assumptions
Balance, end of year

Net liability for future policy benefits
Net liability for future policy benefits
– Less: Reinsurance recoverable
Net liability for future policy benefits, after reinsurance recoverable

This attribution step is intended to capture the amount of the change resulting from updating best estimate assumptions. ASU 2018-12 does not require this attribution item to be broken down into a more granular view. The impact of unlocking assumptions may, however, span over multiple time periods within a year (recurring at the same time each year) and be grouped by products to alleviate the resource strain created by the performance of all experience-related analysis in one quarter. For more transparency and ease of explaining results, a company may decide to show multiple amounts attributed for the various changes in best estimate assumptions (e.g., mortality, lapse, etc.). Generally, this type of analysis of the assumption unlocking is already a common practice for companies that currently perform unlocking for FAS 97-type product best estimate assumptions and FAS 60 loss recognition testing.

Figure 2. Effect of actual variances from unexpected experience

Rollforward for present value of expected net premiums
Balance, beginning of year
Beginning balance at original discount rate
– Effect of changes in cash flow assumptions
– Effect of actual variances from expected experience
Adjusted beginning of year balance
– Issuances
– Interest accrual
– Net premiums collected
– Derecognition (lapses)
Ending balance at original discount rate
– Effect of changes in discount rate assumptions
Balance, end of year

Rollforward for present value of expected future policy benefits
Balance, beginning of year
Beginning balance at original discount rate
– Effect of changes in cash flow assumptions
– Effect of actual variances from expected experience
Adjusted beginning of year balance
– Issuances
– Interest accrual
– Benefit payments
– Derecognition (lapses)
Ending balance at original discount rate
– Effect of changes in discount rate assumptions
Balance, end of year

Net liability for future policy benefits
Net liability for future policy benefits
– Less: Reinsurance recoverable
Net liability for future policy benefits, after reinsurance recoverable

This attribution step is intended to capture the amount of the change resulting from experience emerging different than that expected for the in-force block of business. The example presented in ASU 2018-12 (example 6, section 944-40-55-29M) includes updates to cash flow projections based on unfavorable mortality experience in the current period. This results in an increase in current period benefit payments, which leads to a reduction in future expected gross premiums and benefits due to the change to the projected in-force as the change in current period mortality experience flows through the projections. Although the example focuses on deaths, this attribution should also take into account lapses and/or other changes in actual experience that vary from expected. Capturing these changes would likely require a new model run to remove those policies with a death (and/or lapse) during the current period. Again, policies related to the desired location of reporting will be necessary. How is actual-to-expected variance on new business reflected versus in-force business?

Figure 3. Issuances and derecognition

Rollforward for present value of expected net premiums
Balance, beginning of year
Beginning balance at original discount rate
– Effect of changes in cash flow assumptions
– Effect of actual variances from expected experience
Adjusted beginning of year balance
– Issuances
– Interest accrual
– Net premiums collected
– Derecognition (lapses)
Ending balance at original discount rate
– Effect of changes in discount rate assumptions
Balance, end of year
Rollforward for present value of expected future policy benefits
Balance, beginning of year
Beginning balance at original discount rate
– Effect of changes in cash flow assumptions
– Effect of actual variances from expected experience
Adjusted beginning of year balance
– Issuances
– Interest accrual
– Benefit payments
– Derecognition (lapses)
Ending balance at original discount rate
– Effect of changes in discount rate assumptions
Balance, end of year
Net liability for future policy benefits
Net liability for future policy benefits
– Less: Reinsurance recoverable
Net liability for future policy benefits, after reinsurance recoverable

These lines are specific to new business. Issuances are, as expected, the present values for newly issued business. While issuances appear clear, derecognition is less so. Derecognition is related primarily to new business that lapses or dies prior to the year-to-date end of the rollforward period. For example, if we consider quarter one net premiums (6), this present value includes projected values from January, February, and March new issues. If we consider a single contract issued on January 15 that dies on March 14, the present values of net premiums are in issuances, but where do we remove the projections beyond March 15? The elimination of the excess present values for recently issued policies is the function of derecognition.

Figure 4. Capturing changes

Rollforward for present value of expected net premiums	
Balance, beginning of year	
Beginning balance at original discount rate	
– Effect of changes in cash flow assumptions	
– Effect of actual variances from expected experience	
Adjusted beginning of year balance	
– Issuances	
– Interest accrual	●
– Net premiums collected	●
– Derecognition (lapses)	
Ending balance at original discount rate	
– Effect of changes in discount rate assumptions	
Balance, end of year	
Rollforward for present value of expected future policy benefits	
Balance, beginning of year	
Beginning balance at original discount rate	
– Effect of changes in cash flow assumptions	
– Effect of actual variances from expected experience	
Adjusted beginning of year balance	
– Issuances	
– Interest accrual	●
– Benefit payments	●
– Derecognition (lapses)	
Ending balance at original discount rate	
– Effect of changes in discount rate assumptions	
Balance, end of year	
Net liability for future policy benefits	
Net liability for future policy benefits	
– Less: Reinsurance recoverable	
Net liability for future policy benefits, after reinsurance recoverable	

The adjusted beginning of year balance, premiums collected, interest accrual, and benefit payments attribution steps are intended to capture changes during the period relating to both existing business and new business. Some careful considerations:

- Interest accrual: This attribution is dependent on the assumed timing for premium and benefit payments (e.g., premiums paid at beginning of period would require interest accrual for both beginning of period reserve balance and premium collected). In most instances, the actuarial system will define this timing for both premiums and benefit payments; however, care should especially be taken when aggregation is performed using differing actuarial systems.
- Net premiums collected and benefit payments: Net premiums and benefits paid are based on the complementary decrements, survival, and death or surrender. The frequency of premiums can affect the amounts recognized within these lines. The type and amount of benefits are directly affected by the decrement. Surrender values tend to be much smaller than death benefits for traditional life products.

Figure 5. Net liability for future policy benefits

Rollforward for present value of expected net premiums
Balance, beginning of year
Beginning balance at original discount rate
– Effect of changes in cash flow assumptions
– Effect of actual variances from expected experience
Adjusted beginning of year balance
– Issuances
– Interest accrual
– Net premiums collected
– Derecognition (lapses)
Ending balance at original discount rate
– Effect of changes in discount rate assumptions
Balance, end of year
Rollforward for present value of expected future policy benefits
Balance, beginning of year
Beginning balance at original discount rate
– Effect of changes in cash flow assumptions
– Effect of actual variances from expected experience
Adjusted beginning of year balance
– Issuances
– Interest accrual
– Benefit payments
– Derecognition (lapses)
Ending balance at original discount rate
– Effect of changes in discount rate assumptions
Balance, end of year
Net liability for future policy benefits
Net liability for future policy benefits
– Less: Reinsurance recoverable
Net liability for future policy benefits, after reinsurance recoverable

The net liability for future policy benefits is equal to the present value of expected future policy benefits less the present value of expected future net premiums. If reinsurance exists, the reinsurance recoverable will need to be deducted to arrive at the final net liability for future policy benefits.

Conclusion

At first glance, the future policy benefit rollforward appears simple and straightforward; however, the complexities come to light as companies begin to peel back the layers of each attribution item. Companies may want to break down the components between new issues and current in-force business, as well as starting with the end goal in mind, which are the reporting requirements. It will be important first to understand what is necessary to complete the disclosure requirements and then to work backward to determine the business requirements.

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Endnote

1. FASB, *Accounting Standards Update No. 2018-12, Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, August 2018, https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176171066930.