Targeted improvements for long-duration contracts: How 2025 adopters can capitalize on FASB's extended LDTI timing

As entities embark on their journey for compliance with the Financial Accounting Standards Board's (FASB) published Accounting Standards Update No. 2018-12 (ASU 2018-12) on Targeted Improvements to the Accounting for Long-Duration Contracts (LDTI), there are several areas of focus that can make all the difference in allowing compliance with the standard to propel your organization to greater agility in meeting future business demands. Key activities to keep in mind are:

1. **Develop a road map:** Creating an actionable road map with target milestones will be critical to ensure progress is monitored and effort is dedicated to the program.
2. **Assess your technology architecture:** Now is the time to evaluate your enterprise platforms to streamline any disparate systems and tools. Think about replacing internally developed tools with market-ready vendor solutions to create the potential for transformation.

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3. **Act purposefully:** The effective date will be upon us sooner than most think. Act with urgency to plan early and capitalize on implementation opportunities.

In this document, we will walk through several factors that could influence your company's potential LDTI implementation journey, including:

- Key considerations around technology, strategy, and scope: LDTI as a catalyst for change
- Operationalizing your implementation plan

A "no-regrets" first step is to do an assessment of your current state against the necessary areas for LDTI compliance. This will allow you to identify gaps in your organization, define your future goals, and understand what success could look like when LDTI is effective.

Effective dates for LDTI

After nearly a decade of deliberations with industry leaders and practitioners, the FASB published LDTI on August 15, 2018. This is the most impactful accounting standard change for insurance contracts in almost 40 years. FASB's guidance on LDTI seeks to improve the existing measurement, presentation, and disclosure requirements for traditional and limited-payment insurance contracts.

As of September 30, 2020, per ASU 2020-11, for public business entities (SEC filers, excluding smaller reporting companies, or SRCs), the amendments in ASU 2018-12 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2022. For all other entities (non-SEC filers and SRCs), LDTI will be effective for fiscal years beginning after December 15, 2024, and for interim periods within fiscal years beginning after December 15, 2025. Early application of the amendments is permitted and may support your LDTI implementation considerations and broader finance transformation plans.

As most public business entities are already making progress on their implementation road maps, 2025 adopters will have a longer time frame to operate under the current accounting framework before the effective date and required compliance with the standard. Given the enhanced requirements and complexity involved in implementing LDTI, 2025 adopters should consider starting on their implementation journey as soon as possible (if they haven't already) to take advantage of this transformational opportunity and the additional implementation time provided by the FASB.

Key considerations around technology, strategy, and scope: LDTI as a catalyst for change

As 2025 adopters begin to think about and work through their implementation programs, determining the key areas for strategic decision-making is a critical step toward successful adoption of the standard and mitigating the impacts created by some of its more cumbersome components.

While not comprehensive, some of the areas 2025 adopters can consider from a strategic perspective are:

Consolidated end-to-end technology
An instrumental step in creating a successful LDTI implementation plan is selecting and implementing a consolidated end-to-end technology platform, which provides the opportunity to eliminate systems and tools, many of which are internally created and could be challenging to maintain effectively. Insurers will also need to assess whether leveraging technology from a trusted vendor or building out a platform internally would yield the most optimal results. This step is critical in order to effectively produce accurate and timely LDTI results.

Future-proof the technology platform
After insurers have selected the end-to-end technology platform that provides the best organizational fit for their respective LDTI implementation, they should avail themselves of new technology to help future-proof the platform. This includes the opportunity to embrace the cloud in order to streamline processes within the platform and creating various documentation and record-retention efficiencies given the complex data requirements involved in implementing the standard. Additionally, leveraging a subledger system to (a) pivot to events-based accounting and (b) clean up back-end tools and processes inside and outside of the general ledger is another example of the flexibility insurers need to have in order to enable the long-term success and desired outcomes of their technology platform.

Go beyond compliance

Many insurers are viewing the implementation of LDTI not only as an opportunity to update and modernize their technological framework and infrastructure, but also their financial management capabilities. Companies will need to "go beyond compliance" and, while considering LDTI an important and specific use case, 2025 adopters should keep in mind that statutory accounting and enterprise risk management are just as important to an insurance organization. Companies will need to take this into account and seek to determine the feasibility of certain enterprisewide enhancements while being compliant with the standard. Companies that elect to perform the bare minimum in order to comply with the standard may experience lower costs of implementation, but this could also result in increased costs in other business-as-usual functions due to leveraging less-than-optimal solutions. Overall, while finding this balance, companies will need to go beyond compliance in order to determine the optimal trade-off for their respective organization. Performing a current-state assessment of organizational gaps and potential improvements is critical to successfully and strategically executing effective compliance management.

Automation

Report automation can replace existing processes that are manual, redundant, and cumbersome, allowing for a more efficient allocation of resources at an enterprisewide level. Mitigating reliance on manual reporting processes through report automation enables organizations to spend more time on critical analyses and provides an effective balance in achieving compliance with the standard and considering the needs of other compliance initiatives outside of LDTI.

Enterprisewide regulatory management

Companies that must adopt standards similar to LDTI, such as principle-based reserving (PBR), should understand whether any synergies could be gained from standards such as these and leveraged for the purposes of implementing LDTI. PBR and LDTI have different modeling components and techniques, but share some common characteristics, such as both standards are applied retrospectively and require a detailed review of large amounts of historical data. As such, data management and vendor selection should be assessed at an enterprisewide level to leverage synergies from commonalities shared across both standards, where possible. These synergies could potentially provide increased cost savings for organizations as they delve into their LDTI implementation programs.

Challenges with external data providers

Many insurers rely heavily on reinsurers, third-party administrators, and/or external vendors for report generation. As the standard has increased the amount of reports that these outside parties will need to provide insurers, a challenge presents itself in the quality, level of detail, and expedient receipt of these reports. Given the numerous changes in reporting needs as a result of LDTI, organizations will need to coordinate with their external data providers to determine whether the data they are receiving has the granularity necessary to achieve compliance with the standard. Additional consideration should also be given to situations where there is no historical data to leverage (i.e., no historical data available at the appropriate cohort level in order provide the best estimate of cash flows). In these instances, insurers must identify necessary "workaround" approaches through allocation methods and other in-house techniques.

Impacts on hedging strategy

Under LDTI, there is a presumption among many organizations that fluctuations in earnings and equity will increase. Changes in the baseline of earnings volatility would naturally require organizations to assess if that volatility should be included in prospective hedging strategies in order to foster more predictability in the new expectations of earnings patterns for certain blocks of business.

Transition methods available

LDTI introduces accounting for market risk benefits (MRBs), which is required to be applied retrospectively to all prior periods. The ASU, however, permits insurers to elect either a retrospective or modified retrospective adoption of the standard when considering deferred acquisition costs (DAC) and future policy benefit (FPB) liabilities tied to traditional and limited payment insurance contracts. In order to properly account for these areas under transition, companies might find it beneficial to evaluate the quality and availability of historical data. Companies may want to assess their ability to obtain necessary historical data and assumptions and employ model-validation techniques at the level of detail necessary. Insurers can leverage the evaluation performed to assess data storage needs in order to maintain pace with the increased reporting requirements under LDTI. Additionally, actuarial models should be evaluated in order to determine if upgrades are needed to perform new calculations and functionalities (i.e., cohort-level net premium ratio (NPR) calculations, a revised DAC amortization approach, or attributions for assumption and rate updates).

To effectively address the considerations outlined previously, insurers should leverage various lessons learned from public companies, including the elements that make up the ideal team structure, data requirements, and management of third-party relationships.

Now that we've discussed some key considerations related to the implementation journey, the next step is to embed these thoughts in your road map as you operationalize your plan.

Is LDTI the right next step for my organization?

Most good decisions have two key ingredients in common:

- They are based on relevant and reliable information, and
- They contemplate short-, medium-, and long-term objectives.

Given these complexities, some mutual insurance companies have decided not to continue preparing financial statements under US GAAP, and others may be considering that same question. In determining if your company should continue to produce US GAAP financial statements, management should inform themselves with a bespoke, comprehensive impact assessment. Within the context of that impact assessment, management should consider both strategic and operational priorities. For example:

- How will the company access capital now and in the future? Is an initial public offering (IPO) or merger and acquisition transaction being considered? US GAAP financial statements have evolved as the standard of comparison for investors and rating agencies alike, primarily because they provide a consistent framework to facilitate the comparison of one company to another. Typically, market participants are most familiar with performing a peer-to-peer comparison on a US GAAP basis.
- Will the level of detail required to produce US GAAP financial statements under LDTI provide more timely information to management in determining strategic priorities? LDTI will require insurers to provide comprehensive rollforwards of key asset and liability balances. The information used to generate these rollforwards can provide meaningful insights into the company's operations and key performance indicators.
- Is US GAAP required by any existing counterparties (e.g., debt covenants) or regulators? While this consideration can be overcome, there will be a cost associated with identifying and executing on the necessary changes.
- Does the production of US GAAP financial statements align with a broader financial transformation and/or actuarial modernization effort? As the company considers the implications of principle-based reserving, it may find that its efforts align to many of those under LDTI and, as such, there may be minimal incremental effort to produce US GAAP financial statements.
- If the company's talent pool chooses to no longer prepare financial statements under US GAAP, will there be talent implications, including the current availability of talent to address reporting requirements or ability to attract future talent? Not preparing financial statements under US GAAP limits learning opportunities for your people and may not provide them with the relevant experience they believe they need to be marketable and thus effectively advance their careers. This could potentially further limit the talent pool.

Operationalizing your implementation plan

A consistent element in the successful implementation of LDTI includes a focus on the current-state assessment and gap analysis before developing an implementation plan.

Assemble the project team	Assess data and information needs	Explore vendor assistance	Engage professional services	Develop a plan

Before continuing, let's pause to consider that the nature of this implementation is of long-lasting impact for your organization; reflect on where you have been and where you plan to go. Let's go a little deeper, shall we?

Evidence of challenges

Deloitte surveyed about 15 companies to understand progress against each entity's LDTI implementation plan across 10 primary workstreams. Surveys are completed at six-month intervals, with the two most recent being December 2019 and June 2020. For certain workstreams, the scope of work actually fell further behind plan in the later survey—potentially indicating that steps were not identified in the initial project plan or that resources were constrained.

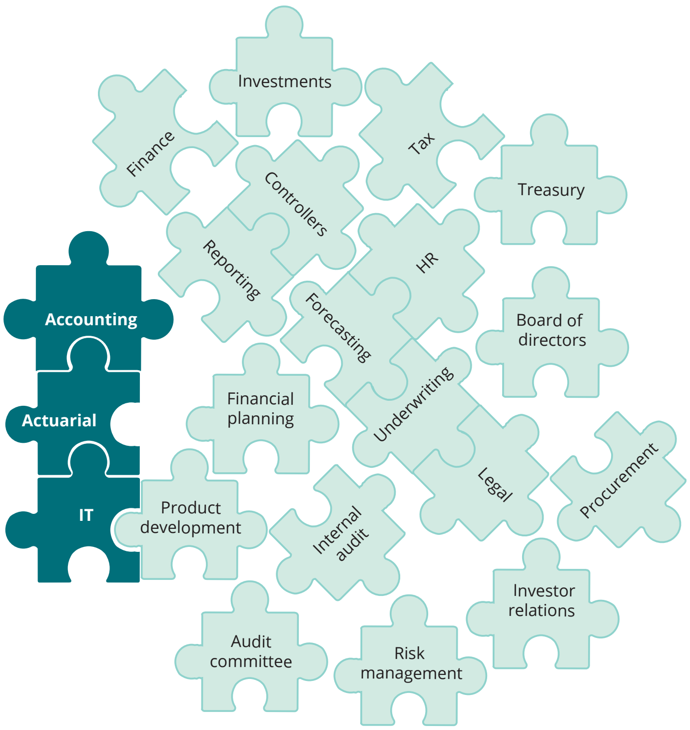
Key workstreams falling behind target

	Data inputs and interfaces	Assumptions and experience studies	Valuation and modeling	Ancillary processes[1]
December 2019 actual vs. target	-3%	-4%	-3%	-1%
June 2020 actual vs. target	-9%	-6%	-6%	-4%

Assemble a multidisciplinary project team

While the three departments that will be primarily involved in the implementation of LDTI are accounting, actuarial, and IT, impacts on others do need to be considered to ensure a well-thought-out implementation. Experience has taught us that no single person has all the answers to advise on each aspect of the standard's adoption. Project sponsor(s) who can assemble a diverse, multiperspective team with experience ranging beyond accounting, actuarial, and technology will be key to increasing the probability of a highly integrated transition and avoidance of blind spots. Companies need to ensure there is effective communication and collaboration across all lines and departments.

1. This includes areas such as a financial impact assessment, KPIs, FP&A, and pricing and product development.



Data and information needs

Keeping the end in mind

Visualize your optimal future state, considering that the implementation of LDTI will require data, modeling, process, and reporting changes. Working backward to solve for all of these required elements will allow your organization to build scalability and flexibility into your plan. By leveraging sponsor(s) and a multidisciplinary project team, your organization can pull from diverse perspectives and experiences to draw the maximum benefit out given the monumental accounting update.

Enhance past decisions

The previous standard, and those that followed it, likely required some expedience to effect implementation given data and system limitations, as well as product feature nuances. With such a tectonic shift, we have observed organizations taking this rare opportunity to gather their available historical data to revisit product classification beyond that which is required to identify MRBs and restructure their general ledger's chart of accounts to extract salient information for internal and external reporting needs.

Disclosures enhanced

With account mapping being further customized to facilitate compliance with the standard's complex disclosures (which will provide management and users of the financials greater insights), we find that certain manual, upstream processes may not be effective or efficient in sustainable compilation for reporting purposes. Therefore, redefining reporting processes via substantial redesign of the current process data collection for transition and future reporting can be scaled to your organization's preferences, resources, and long-term vision. Such disclosures should flow more directly from actuarial processes, which may require modernization in terms of both process design and system structure.

Controlled data flows

As process and/or data flows are reshaped due to the growing and disaggregated asset- and liability cohort–laden rollforwards and other data-intensive disclosures, the need for scalable, flexible, and integrated data flows will mandate process security in the form of controls (manual and automated) and enhanced governance protocols.

Lessons learned

Policy and methodology	Technology, models, and data	Reporting	Process and internal controls	Other downstream impacts
• A significant undertaking that should involve multiple stakeholders, beyond the traditional accounting policy team. • Defining cohorts and discount rates is nuanced.	• The time required for sourcing data and testing is more than anticipated, highlighting challenges in valuing product types and booking results to ledger. • Companies are dependent on when technology providers make new releases.	• LDTI will result in new KPIs for purposes of management reporting. Agreement is needed from senior management and the board regarding how performance will be measured in the future. • Source of earnings analysis can be created or enhanced to clearly articulate the earnings result using LDTI.	• Completing end-to-end process risk assessments may be overlooked, resulting in rework during test runs. • With the deferral, many organizations are looking to reduce reliance on spreadsheets and streamline processes.	• LDTI will result in new KPIs for purposes of management. • Any current bonus or compensation plans that reference KPIs or performance indicators that will not be available after the adoption of LDTI need to be amended. • Management will need to consider how to articulate the impacts of LDTI to the board and rating agencies.

Based on our roundtables and other discussions with insurers, modernizing the financial reporting process will likely require external assistance.

Vendor assistance

We suggest starting with your preferred vendors. Their familiarity with your organization's architecture and current capacity may suit your needs. Contact them and understand their enhanced capabilities and timing. Namely, given pervasive impacts on actuarial systems and software, many such vendors have released or are planning to release new versions of their applications or new systems altogether. Some may have strong data storage solutions for experience study databases or repositories to facilitate more seamless future-state data flows. Gather such intelligence now to determine when updates have been released, what is still yet to come, and what customization will be required to fit your planned needs.

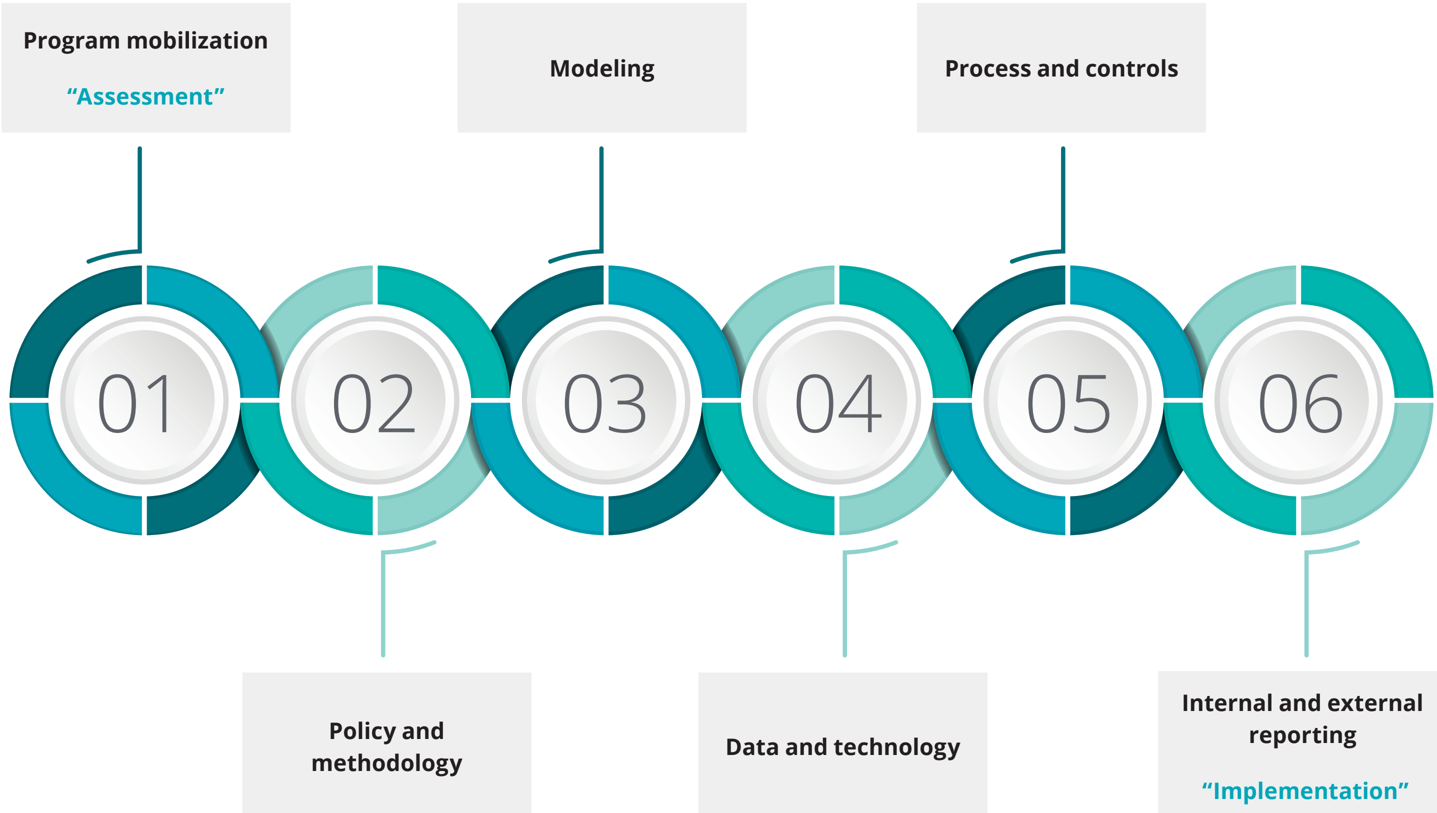
Professional service assistance

Along these lines, reach out to your preferred professional services firm to leverage their specialized skills and expertise with LDTI. Such firms will bring a unique perspective and experience gained from working with your peers in the industry. Additionally, professional services firms often have worked hand-in-hand with the industry to prepare for this change. They have actively followed the development of ASU 2018-12 and helped to form industry positions through involvement in various technical organizations.

Professional services firms often have tools specifically created to support successful ASU 2018-12 implementation and can serve in many different roles to provide support throughout your implementation journey. For example, additional professionals to support employees who are implementing ASU 2018-12, advisers to provide insights when making key decisions, and specialists with a vast array of industry knowledge. These firms' understanding of the current state of the industry and ASU 2018-12 gives valuable context: They can help you assess potential solutions and meet challenges all companies may face implementing the new standard.

Develop a road map

Next, build a road map—a project plan with key milestones for implementation. Consider disaggregating each milestone into more detailed focus areas with key dates to meet your organization's objectives. Setting a cadence for regular engagement with executives, the board of directors, and/or those charged with governance will allow for the appropriate level of monitoring progress against the plan. A timeline of key workstreams with suggested timing for initial discussions, detailed evaluations, and conclusions will provide the necessary guide rails along the journey.


Program mobilization
"Assessment"
Modeling
Process and controls
01
02
03
04
05
06
Policy and methodology
Data and technology
Internal and external reporting
"Implementation"

Time to engage

Considering that the implementation of new accounting standards can be taxing and complicated, those faced with change may not embrace it. Nevertheless, change is coming; be prepared!

LDTI provides an opportunity to revisit, enhance, and reshape your organization. Considering the enhanced requirements, complexity involved in implementation, and coordination required across various aspects of your organization, 2025 adopters should consider starting on their implementation journey sooner rather than later to truly take advantage of this opportunity, as well as the deferred effective date provided by standard-setters, to modernize your organization's architecture.

Contacts

Vincenzo Alfano
Managing director
Audit & Assurance
Deloitte & Touche LLP
valfano@deloitte.com
+1 973 602 6285

Chrissie Barsouian
Managing director
Risk and Financial Advisory
Deloitte & Touche LLP
cbarsouian@deloitte.com
+1 617 437 2161

Matthew Clark, FSA, CFA, CERA, MAAA
Principal
Actuarial and Insurance Solutions
Deloitte Consulting LLP
matthewclark@deloitte.com
+1 312 486 0185

Tom Fekete
Partner
Audit & Assurance
Deloitte & Touche LLP
tfekete@deloitte.com
+1 973 602 6079

Tina Mi
Partner
Audit & Assurance
Deloitte & Touche LLP
tmi@deloitte.com
+1 203 708 4750

Theresa Koursaris
Senior manager
Audit & Assurance
Deloitte & Touche LLP
tkoursaris@deloitte.com
+1 212 492 3666

Tannisha Troutman
Senior manager
Audit & Assurance
Deloitte & Touche LLP
ttroutman@deloitte.com
+1 973 602 4110

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