Long-Duration Targeted Improvements (LDTI) readiness

In August of 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2018-12 (ASU 2018-12 or LDTI), which amended the accounting model under US GAAP for certain long-duration insurance contracts. The FASB's intent was for the ASU's targeted improvements to provide more timely and useful information to financial statement users in addition to simplifying how insurers apply certain aspects of the accounting model for certain long-duration contracts. When the standard was announced, the transition date was January 1, 2019, with an effective date of January 1, 2021, for SEC filers. The FASB subsequently revised those dates twice, with the most recent revision, approved in November 2020, extending the effective date for SEC filers to January 1, 2023. We will explore how the industry has progressed to date with implementing the new accounting standard, where companies may shift their focus given the additional time, and some of the challenges faced on the implementation journey.

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Progress to date

Based on the second survey conducted by Deloitte as of June 2020, companies are not far behind in their LDTI implementation plans. Note that this survey was conducted prior to the FASB formally deferring the implementation date to January 1, 2023. The intent of the survey was to capture the progress of the industry against its implementation plans across the following areas:

- Accounting policy and actuarial methodology
- Data inputs
- Valuation modeling
- Outputs and reporting

The survey included a mix of 14 domestic and international companies that are subject to the LDTI effective date of January 1, 2023, 12 direct companies, and two major reinsurers. Overall progress doubled since the first survey conducted at year-end 2019. Across the different areas, companies had completed an average of 35% of their workplans against a target of 41%. Companies have recognized that the work efforts involved in implementing LDTI are larger than initially anticipated. They continue to learn about the wide-reaching impacts of LDTI as new processes, technologies, and capabilities are built.

Survey participant averages

Implementation plan areas	Actual % complete	Target % complete	Difference
Accounting policy and actuarial methodology	58%	65%	-7%
Data inputs	39%	46%	-7%
Valuation modeling	50%	57%	-6%
Outputs and reporting	21%	24%	-4%
Total	35%	41%	-6%

Survey results showed that focus to date was on accounting policy and actuarial methodology, data inputs, and valuation modeling, with less effort on outputs and internal and external reporting needs. Drafting of accounting policy was the leader in terms of progress. This component of the LDTI implementation is one of the most critical. Key accounting policy decisions, such as cohort definition and level of granularity, need to be prioritized, as these decisions have implications for data, processes, and technology. Companies have also concentrated efforts on identifying the increased input data needs and enhancements, as well as advancing actuarial calculations under the new requirements.

A shift in focus to other key areas

Our survey results highlighted multiple areas that will require significant focus going forward. These areas are in the category of "operational readiness" and include conducting end-to-end testing; performing restatements and parallel runs; tackling internal and external reporting; and addressing changes in process, controls, and automation.

End-to-end testing

Given the progress made on data inputs and valuation modeling activities combined with the FASB deferral, companies are in a better position to increase the amount of end-to-end testing. System/integration and user acceptance testing activities will be critical to ensure a cohesive end-to-end process. It will be necessary to validate that the hand-offs at each point in the process are working correctly by testing the data inputs, model calculations, model outputs, and reporting aspects.

Internal and external reporting

Most companies have spent minimal time on assessing the impacts of LDTI on internal and external reporting needs. For internal reporting, emphasis on defining various management reports, dashboards, and metrics will be needed. Significant enhancements to the financial reporting disclosure requirements have been introduced with LDTI. This requires an increase in the volume of data that must be stored, controlled, and reported externally. Creation of standardized financial reporting disclosures and rollforwards will aid in an efficient close process. These activities take longer and are more complex than may be anticipated. The additional year will enable companies to take the time to build a more robust suite of analytical tools necessary to support internal and external reporting needs.

Process, controls, and automation

Once the data, valuation modeling, and reporting aspects have been mostly established, processes and controls can be assessed, refined, or newly created. Performing model validation and control testing over the restatement can occur for an increased number of quarters, given more time allotted for performing actual parallel runs. With greater volume of data and different reporting bases, data aggregation and provisioning tools will need to be fast and automated to avoid substantial manual effort. Further automation of the end-to-end process can be introduced to reduce the risk inherent in manual processes and to shorten the working-day timetable.

Restatements and parallel runs

Restatement of prior-period financials has a high level of risk given potential time constraints and the level of historical data and analysis required. It will be important to perform restatement calculations on the future-state end-to-end systems platform, so planning should anticipate several rounds of iteration as the platform continues to be refined. The additional time can be useful in managing execution risk to provide comfort with revised prior-period results. For parallel runs, companies will be better positioned to perform up to a year of parallel testing, as opposed to only one or two quarters of parallel testing under the prior timeline.

Challenges along the way

While companies have made progress, the implementation journey has not been without its challenges. The current economic environment and the move to a remote work environment due to COVID-19 has disrupted implementation. The continued deliberation by the industry over a number of key areas, such as market risk benefits, discount rates, unit of account, and reinsurance, has also delayed progress.

COVID-19 has resulted in a remote work environment and presented additional challenges for the LDTI implementation journey. Working virtually has added a layer of complexity and inefficiencies, an impact on collaboration, and a shift in priorities to address ad hoc requests.

Work inefficiencies. Working from home introduces a factor of inefficiency and distraction. Large data sets and actuarial models require significant computing power and capacity. Some companies have experienced slower processing times, while for others, accessing systems and applications remotely has been a bit more difficult.

Impact on collaboration. Collaboration across actuarial, IT, accounting, and finance is critical to the successful implementation of LDTI. The remote work environment has introduced the inability to physically go to the whiteboard, brainstorm as a group, and draw ideas to aid in facilitating solutions. The ability to simply walk over to a colleague's desk to try to solve a problem no longer exists in the current environment.

Shift in priorities. With so many changes in the economic environment and the need to communicate results and additional analyses internally and externally, many resources were shifted from their LDTI implementation responsibilities. These resources were temporarily diverted from their implementation activities to perform various ad hoc analyses to address impacts from COVID-19 and the low-interest-rate environment on business operations and to analyze potential impacts on financial statements.

Where does the industry go from here?

With the most recent FASB deferral, companies that do not adopt LDTI early have an extra year to dedicate more time to areas that may have been cut short with the prior timeline. Some companies are absorbing the extra year into their implementation plan, moving “Day 2” items into the implementation timeline, and using that cushion to educate key stakeholders. Although the extra year provides some reprieve, many companies are forced to balance the constraints of their budgets (or reduced budget) with spreading those dollars over the additional time.

In closing

Although 2020 has brought challenges, companies continue to make progress on their LDTI implementation activities. The majority of companies have not taken their foot off the pedal and are charging forward with their LDTI implementation. Companies have the opportunity to recover a bit from COVID-19-related challenges, continue to stay in tune with industry developments on areas of ambiguity, and shift focus to areas where less progress has been made to date.

Deloitte’s next survey is planned for the end of 2020, and those results will capture how companies continue to deal with COVID-19-related challenges, the current economic environment, and the continued evolution on technical topics by FASB and the industry.

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