LDTI—A Path to Optimizing Compliance and Transformation

By Naxine Chang

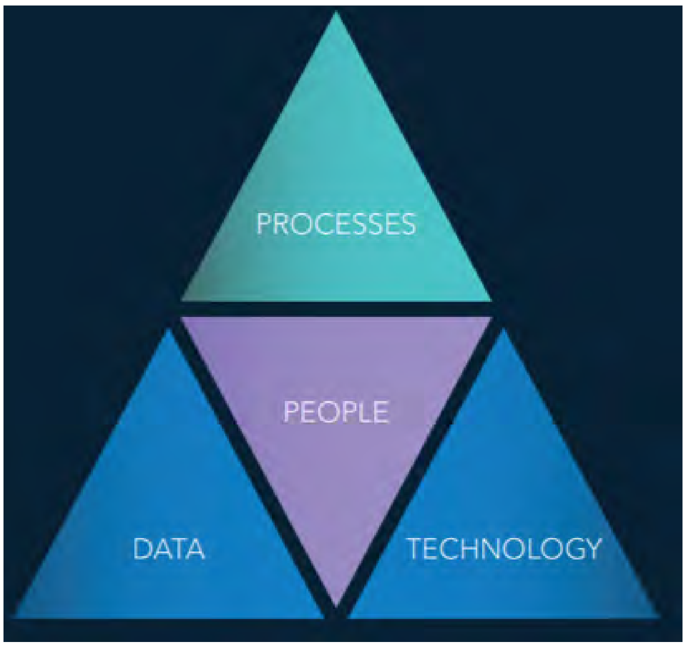
Among the nation's oldest industries, the insurance sector is experiencing a slow-but-sure evolution. The past decade's persistent low-interest rates and shifting demographics challenge insurers—and life insurance companies in particular—in their efforts to keep expanding market share and increasing profits.

Beyond socioeconomic pressures, insurance companies also face intense scrutiny from regulators demanding high-level business transparency. One example is ASU 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts (LDTI)*,[1] issued by the U.S. Financial Accounting Standard Board (FASB). To provide insurance companies additional time to implement the new standard, a revised effective date of Jan. 1, 2023, applies to U.S. Security and Exchange Commission filers that are not defined as a smaller reporting company; and Jan. 1, 2025, for all others.

LDTI's requirements aim to bring more relevant financial measures and transparency with frequent assumption review, a unified measure of market-based options or guarantees, simplified amortization of deferred acquisition costs (DAC) and enhanced disclosures.[2] The principles of these targeted improvements, in comparison to the current U.S. Generally Accepted Accounting Principles (GAAP), increase the complexity of data requirements, including data storage and management. They also complicate the scope and processes required to produce disclosure requirements.

LDTI's introduction has forced many insurers to examine their existing operations and technologies. They must determine how to optimize compliance efforts while balancing data, analytics and system modernization considerations to achieve maximum value. This article will examine the four key facets—the data, technology, processes, and people—essential to any successful LDTI exercise. It will also comment on the various approaches for tackling LDTI and how an innovative mindset can help insurers realize much greater transformation for the business.

Figure 1
People are Central to any LDTI Implementation



FOUR KEY IMPLEMENTATION CONSIDERATIONS

In compliance with LDTI, companies will need to manage data requirements, automate sourcing, perform LDTI calculations, generate ledger posting entries and fulfill all FASB disclosure requirements. This is a tremendous challenge—but also an enormous opportunity. Companies that modernize their capabilities wisely will do far more than gain the ability to comply with LDTI. Done right, they will create a technology infrastructure and mindset that can position them for future growth.

To succeed, insurers must first understand and consider four key aspects of implementation: data, technology, processes, and people. (See Figure 1)

Data

Common data issues are generally related to the varying granularity, availability, quality, and dispersal of that data. These constraints impact the LDTI transition methodology a company chooses—e.g., full retrospective or modified retrospective transition method.[3] They also impact the level of aggregation or grouping, such as calculation for liability for future policy benefits (LFPB), DAC amortization, cash flow assumption setting and disclosure reporting presentation.

At a minimum, the insurer's data management capabilities should enable the automation of data integration. This includes the ability to retrieve policy data from internal or third-party administration and reinsurance systems; to reconcile source data and then feed it through downstream computation, ledger posting and reporting engines; and to store policy information and financial results in a secure, yet easy to access, data lake or results repository (in a cloud or on-site).

New data architectures and data management capabilities should ultimately provide a single source of truth to enable business forecasts and decisions. Many insurers are expanding their data focus into areas beyond LDTI, including:

- Supporting frequent experience analysis and actuarial assumption setting to align emerging business experience and pricing to the underlying risk;
- enabling risk and profitability management and communication with internal and external stakeholders; and
- enabling connections with other aggregated data sources, such as government and third party data, to facilitate analytics. This can help to enhance the policyholder experience during the sales, underwriting and claim processes.

Technology

Insurers will want to reach a consensus with internal and external auditors regarding their actuarial methodology and accounting policy for LDTI. Once data requirements are defined based on policy decisions, insurers are bound to orchestrate the entire data flow for financial analysis and business insights.

Actuaries should assess the actuarial systems capable of performing calculations with frequent assumption updates to support quantitative and qualitative information for disclosures and analytics. These include such measures as the net premium ratio, LFPB, deferred profit liability, DAC amortization over the expected life of the contract, and fair value valuation of market risk benefits (MRB). The finance teams should assess accounting ledger systems capable of configuring the chart of accounts, sub-ledger posting rules, and accounting event hierarchies to support the management of financial data. Both sides must agree on the scope of financial information required to articulate the financial story to management for discussion and reporting.

Current actuarial and accounting systems are often designed in isolation, with little or no integration capability. Many of these systems have integration points that still rely on manual processes like spreadsheets, Microsoft SQL Server or Microsoft Access databases. These shortcomings hinder scaling and layering automation needed to deliver the speed, accuracy, and transparency demanded by LDTI.

While companies decide between a modular solution that covers the gap with existing systems, or investing in a strategic end-to-end solution, there are three essential capabilities to consider:

1. An open-box computation engine with integration to data lakes or source systems and a results repository;
2. a full sub-ledger posting infrastructure to bridge actuarial and accounting functions to minimize manual processes; and
3. advance reporting with pre-defined FASB disclosures and user-defined visual financial analytics that provide drill-down capabilities, such as illustrating attributions due to the effect of changes in a) discount rates and cash flow assumptions for the LFPB rollforward, and b) market data or future expected policy behavior for MRB.

Insurers that plan to file financial statements on a dual-accounting standard, such as International Financial Reporting Standard 17 (IFRS 17) and LDTI, can further benefit from technology synergy to save time and cost. The dual-standard requirements can be fulfilled in a centralized environment using a unified technology platform during the financial close.

Processes

An insurer's LDTI process needs to be repeatable in an automated and governed environment. The process is obliged to satisfy auditors' requirements with sufficient controls and documentation. Three capabilities must be paramount:

1. The ease of moving financial information from the actuarial system to the accounting system in a controlled, auditable, and traceable environment;

2. the process fits within the financial closing calendar, complementing the present and future-state ecosystem and staying current with regulation updates; and

3. reduction of existing manual processes and touchpoints with a clearly defined workflow framework.

A similar process should also apply to other financial reporting processes—for example, the U.S. statutory reporting required by the National Association of Insurance Commissioners. A comprehensive accounting reporting process provides a holistic view of business insights within different financial lenses and enables actuaries and accountants to communicate financial results.

A governance process is foundational for evaluating the health of an enterprise risk portfolio. Similar governance disciplines could be adopted and deployed to other functions such as sales, billing, underwriting, claim process, and product development. These disciplines become rewards in the long run.

People

While organizations tend to focus on the data, technology, and process facets of large-scale initiatives, it's important to remember that people are at the center of any LDTI implementation. LDTI will require integrative organizational changes and demand collaboration across the IT, accounting and actuarial departments. The level of staff enablement will vary and demands alignment before developing LDTI requirements. Implementation will also require the full-time attention of a multidisciplinary internal team augmented by external subject matter experts, including a technology provider with robust industry expertise. Companies that act quickly will have an edge in securing the proper resources.

Seizing the opportunity to transform and modernize also presents a valuable opportunity for insurers to begin closing the sector's long-standing talent gap. Promoting the right data, technology and processes can help attract, motivate and empower insurance professionals with a penchant for tech-savvy analytical applications, automation and interface platforms. In turn, attracting and retaining highly skilled and loyal employees—from distribution channels to customer administration and service, underwriters to actuaries and accountants, and technology stewards to data scientists—can become a differentiator from one's competition.

NO TIME TO WASTE

Among many competing priorities for the insurance industry, achieving operational excellence with a smart business model is among the most pressing. At the top of the list are technology modernization and innovation. The industry has been playing catch-up with technology, as replacing legacy systems and processes with new technology across complex ecosystems can be a daunting task.

Buy Versus Build

"Buy versus build" is one of the most critical early decisions that companies will make for LDTI compliance. Building in-house capabilities can provide a sense of control. However, in an ever-changing climate, insurers must ask themselves if they have the appetite for complex application development that must be done correctly and on-time.

Companies that went through a similar regulatory compliance exercise with IFRS 17 learned some valuable lessons about homegrown solutions. Tackling the intricacies of LDTI will require skilled project management, IT, actuarial and accounting resources during the design, development and implementation phases and far beyond. The biggest potential pitfalls include:

- **Ongoing regulation updates:** Is the organization certain it can successfully complete each element required for an end-to-end process while staying current on all existing requirements? Is it also comfortable anticipating (and complying with) future changes to regulatory requirements?

- **Time/resources:** Is the organization comfortable assuming the risk of delivering the capabilities on time? Does it have sufficient governance processes and resources?

- **Costs:** What will the development of in-house capabilities ultimately cost the organization? Competing organizational priorities and unpredicted requirement changes can make implementation and operational costs uncertain.

Taking these factors into account, most insurers favor the "buy" strategy or a hybrid approach, which enables them to mix internally developed components with external solutions. Using in-house development and aligning external partners can optimize the speed and flexibility with which companies transform.

The Path to Transformation

As consumer behavior and demographics shift across markets, insurers ought to find ways to demonstrate value to an ever-broadening clientele with diverse needs and preferences. This makes pricing to the right level of risk and building long-term financial strength and trust among the insured more important than ever. Insurers are applying the LDTI-inspired financial transformation mindset to other scalable business transformations to win customer loyalty while achieving operational excellence with initiatives like:

- Adding predictive modeling and artificial intelligence tools to target new markets with culturally and financially relevant outreach,

- shortening the insurance application process with digital automation and online customer interfaces,

- simplifying and accelerating the underwriting process,

- streamlining claim processes to improve policyholders' experience, and

- friction-free strengthening of fraud detection and protection algorithms throughout the policy life cycle.

The insurance industry has proven its value to the market over the past decades, but to thrive in a competitive market, insurers must create new value propositions to increase market share and profitability through innovation. LDTI is one of many exciting opportunities for life insurance companies to transform, and the time to start is now. ■

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ENDNOTES

1 *www.FASB.org.* The FASB issued the new accounting standard ASU2018-12 - Financial Services – Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts (LDTI). The new standard applies to all public and private US companies, and US companies with international business that have certain long-duration life Insurance contracts and GAAP regulatory compliance requirements.

2. FASB's In Focus, Aug. 15, 2018. *https://www.fasb.org/cs/ContentServer?c=FASB-Content_C&cid=1176171063168&d=&pagename=FASB%2FFASBContent_C%2F-GeneralContentDisplay*

3. *www.FASB.org.* ASU 2018-12 944-40-65-2 requires measuring market risk benefits using a full retrospective transition approach.