20 - US GAAP Long Duration Targeted Improvements Implementation

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2019 Valuation Actuary Symposium

RYAN KIEFER

Session 20, Long Duration Targeted Improvements Implementation

August 26, 2019

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Valuation Actuary Symposium: ASU 2018-12

Incremental Data Requirements and Control Enhancements in an LDTI World

August, 2019

Changing regulations create "disruption" and trigger more work on compliance and transformation

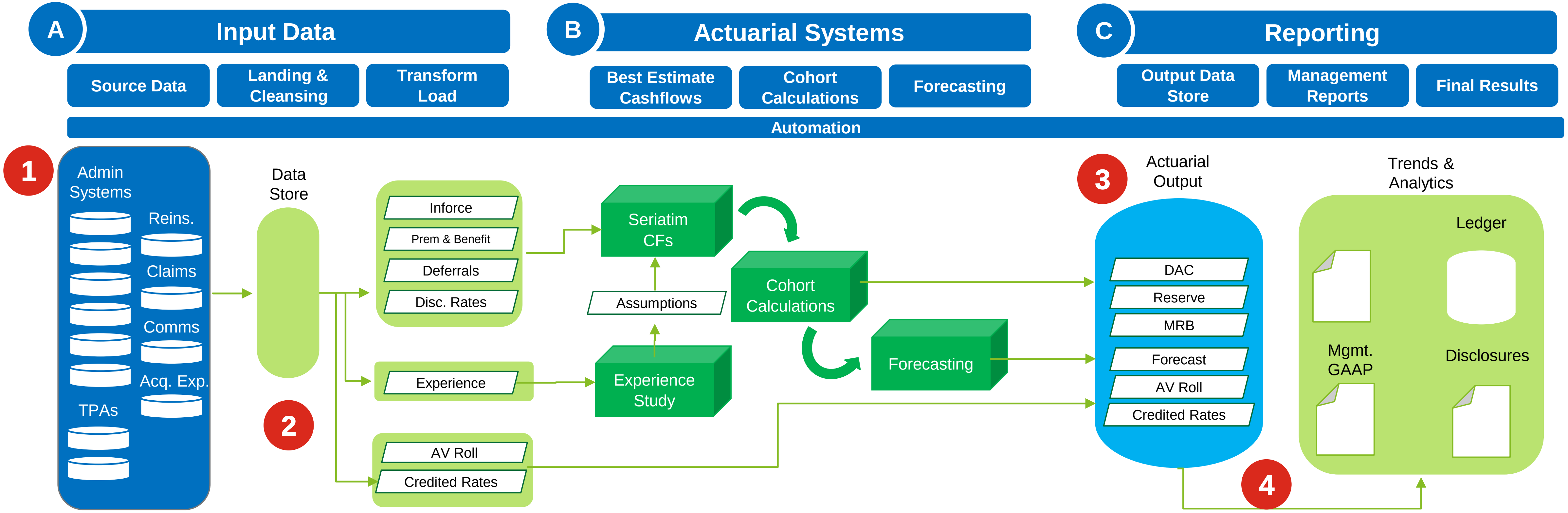
Pervasive impact on the operating model of insurers:

	Processes and Systems	Enhancement of existing or adoption of new models and processes. Significant efforts expected for model design, build and implementation, with multiple reporting bases in mind.
	Data Requirements	New data elements need to be built into the actuarial and accounting systems and processes, due to stochastic modeling requirement and enhanced financial reporting disclosure.
	Market Reporting	More figures subject to audit and fast close process under greater pressure to deliver new figures to the market. With financial reporting offering better comparability, more questions anticipated from analyst/rating agency.
	Governance	Enhancement on governance and controls framework to validate process and controls effectiveness on new elements of financial reporting.
	Management and Strategy	Planning and forecast need to adapt to new metrics arising from changing regulations. Valuation changes impact pricing and product design, as well as KPIs, management reporting and ALM.
	People, Organization and Culture	Changes such as IFRS17 and LDTI require cross-disciplinary collaboration for implementation. Interaction between finance, risk and actuarial will increase, and demand for actuarial/accounting resources across the globe will multiply over the next few years.

Focus of Today's Session

Data Challenges and Considerations Due to LDTI

While ASU 2018-12 is an accounting standard, there are clearly meaningful impacts to the data insurers will require – some of those key impacts are shown in a reference architecture below



Success Factors

1. Rationalization of potentially numerous admin systems and other data sources
2. Front end data store to cleanse, format and standardize data, and ensure a single source of the truth for downstream processes
3. Assessment of storage capabilities of current data stores/lakes will be critical. Subledgers/or other data solutions may be required
4. Output data store that is flexible enough to promote seamless querying of output information for reporting and is properly controlled

Successful implementation of ASU 2018-12 requires high quality governed granular data – beyond what many insurers have ready

	Blockers	Enablers
Retrospective Data **The quantity and quality of historical data available determines your transition opportunities and flexibility**	• Source systems with data quality issues and lack of system expertise • Insufficient granular policy data • Lack of historic economic and non economic assumptions	• A detailed understanding of data required and current gaps at source
Increased Data **Maintaining granular transaction data and portfolio and cohort information will enable optimized granularity and accuracy of calculations and improve experience analysis**	• Manual processes inhibiting data flow between components of the financial architecture • Aggregation of transaction or policy data	• Integration of source system, finance, and actuarial systems • Conformed data across end to end architecture
Increased Data Volumes **Retrospective data capture, greater granularity, augmented attribution and NPR will increase data storage and processing needs**	• Low capacity data stores that cannot cope with volume • Manual data processing and reporting tools	• Early analysis of likely data volumes • Enterprise-quality reporting solution and sufficient storage

Once the data aspects are solved, there remains a real need for enhancements to the finance platform from data aggregation to reporting

Area	Blockers	Enablers
Data Aggregation and Provision **Data aggregation and provisioning needs to avoid manual intervention to avoid delays and excess effort**	• Use of manual aggregations and data provisioning tools • Inflexible cubes and data marts that cannot adapt	• Apply changes to data aggregations and provisioning tools, providing the new data or reporting bases required
Business Intelligence **In addition to the impact on financial reporting, consumers of management information and analytics may expect to see information on an ASU 2018-12 basis**	• Inflexible reporting tools that cannot adapt to the new metrics and report formats required • Gaps in underlying finance systems that need to be resolved before new reports are designed	• Extension to reporting tools or sourcing of new tools that are adapted to the regulation
Financial Reporting **Financial reporting systems need to report on multiple bases in a reconciled manner while meeting tight working day timetables**	• Reporting silos • No single version of the truth for Close & Consolidation • No efficient way to monitor progress against the working day timetable across all dependent reporting streams	• Robust working day timetable and monitoring systems across all reporting streams

The Financial Reporting Process – Analysis of Future State

Current State vs Future State Data and Control Considerations

	Current State	Future State
Product Classification	• Use aggregated pricing cells to assess level of mortality/investment risk to assess proper accounting framework	• Seamlessly split out participating products • Split rider/base contract as may be required for MRB classification
Experience Studies and Assumption Setting	• Extensive ad-hoc data cleansing • Use of “best available” data which may or may not be controlled • Data granularity to suit current needs	• ETL/data cleansing process automated • Single controlled “source of truth” • Data available at a granular level that can be easily queried
Reserves	• Cleanse data from multiple sources • Locked in assumptions • Detective controls for incomplete/non-sensical data	• Automated inforce data feed, with proper cohort identification • Historical transactional data systematically integrated into reserve process • Best estimate assumptions • Two discount rates: locked-in discount rate, market rate • Preventative controls to reduce risk of reporting errors

Controls across all components will need to be assessed, enhanced, or redesigned

Current State vs Future State Data and Control Considerations

	Current State	Future State
DAC	• Cleanse data from multiple sources • Locked in assumptions • Allocated expenses to seriatim level	• Greater data requirement for cohort approach • Automated inforce data feed, with proper cohort identification • Allocated expenses to the level of calculation granularity • Best estimate assumptions (cohort level calculations only)
Internal Reporting	• Combination of system generated reports, and ad-hoc spreadsheet analysis • Simple/predictable trends/expectations • Control demonstrated through spreadsheet reviews	• Additional model runs/data required to explain results, execute attribution analyses • Redesign of tools and templates with associated data requirements • More robust review controls
Presentation and Disclosures	• Data is largely qualitative and informational • Minimum actuarial involvement	• May need to create an in-house system for disclosures • Increased number of valuation runs and data volume needed for disclosures • Significant increase in disclosures, including products not impacted by LDTI such as UL (e.g. policyholder account balance roll-forwards, interest credited, etc.) • Accounting rules engine and chart of accounts work may be needed

Controls across all components will need to be assessed, enhanced, or redesigned

Current State vs Future State Data and Control Considerations

	Current State	Future State
Transition	**N / A**	• Historical policy data is required for demonstrating transition approach and retrospective net premium ratio ("NPR") calculations • Historical cash flow assumptions are necessary to apply a retrospective or partial retrospective transition method
Reinsurance	• Lagged data and data quality issues exist preventing seriatim valuation using data as of the reporting date for reinsurers • Estimates for data lag / aggregate models for reinsurance have been developed	• Lagged data/data issues will likely continue to exist, but estimates will need to be refreshed on a more frequent basis • Data will need to be tagged with cohorts on a gross, assumed and ceded basis

Controls across all components will need to be assessed, enhanced, or redesigned

Evolving toward the future

Yesterday's solutions may not adequately support today's need for rigorous data quality and storage standards to support compliance and future growth.

A modern data foundation is the critical success factor

LDTI drives the need for better data at all parts of the environment

- ✓ More data elements
- ✓ More history
- ✓ Increased granularity
- ✓ More flexibility in modeling cohorts
- ✓ Better lineage from summary reporting to the lowest level of detail required for analysis

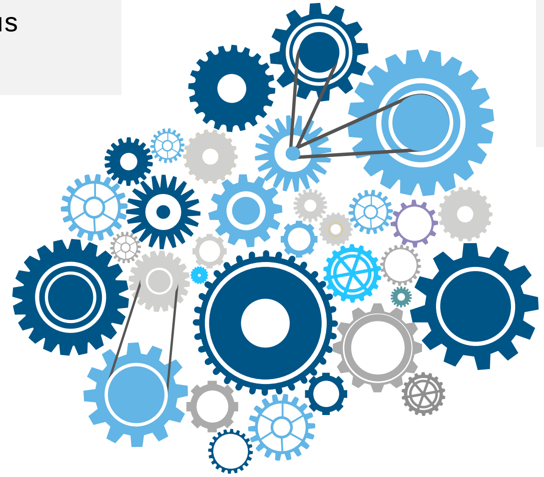
Focus areas to modernize operations

Modern Data Platforms

- Cloud-based big data platforms can scale more easily than existing on-premise databases
- Handle significantly increased volumes of data, more rigorous analytics and modeling

Cognitive Data Stewardship

- Machine learning can help automate and improve the effectiveness of data stewardship activities



Business Analytics

- Use of RPA and NLG to enable processing and complex actuarial workflow to generate additional disclosures and reconciled financial statements

Data Aggregation Tools

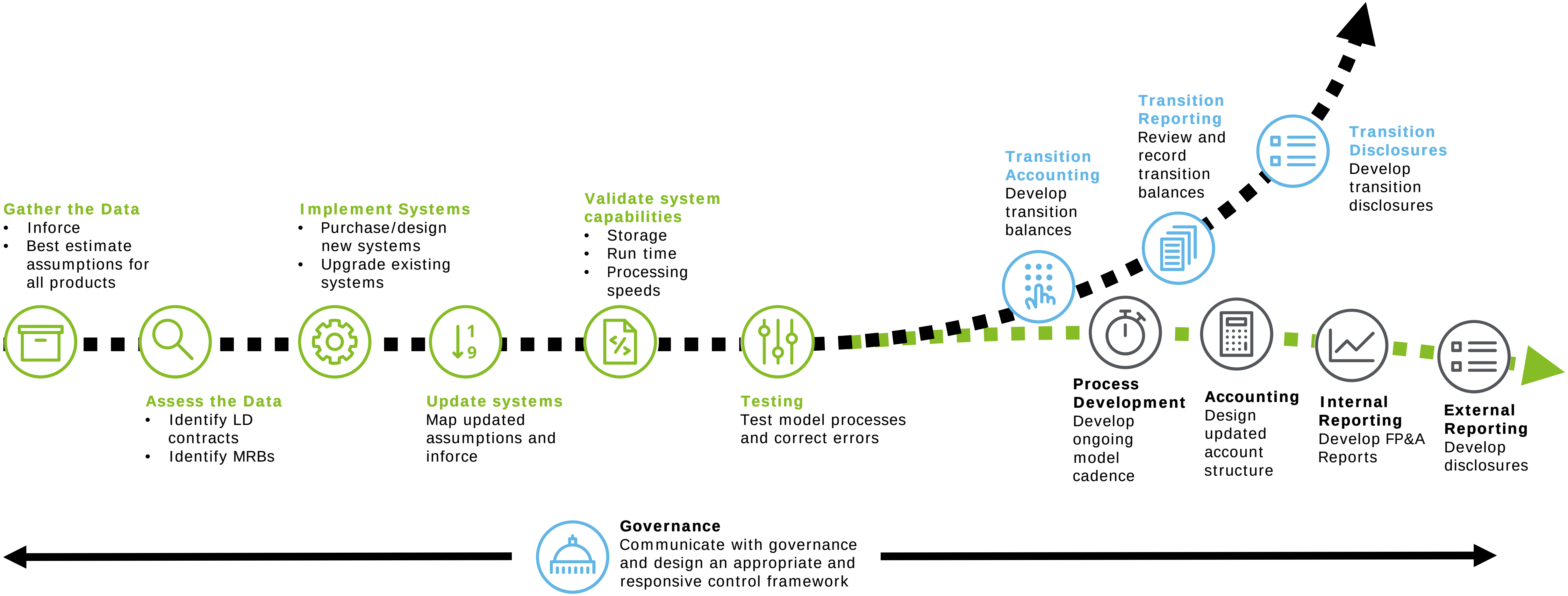
- Data aggregation tools will aid in avoiding substantial manual effort given the increased volume of data

Controls

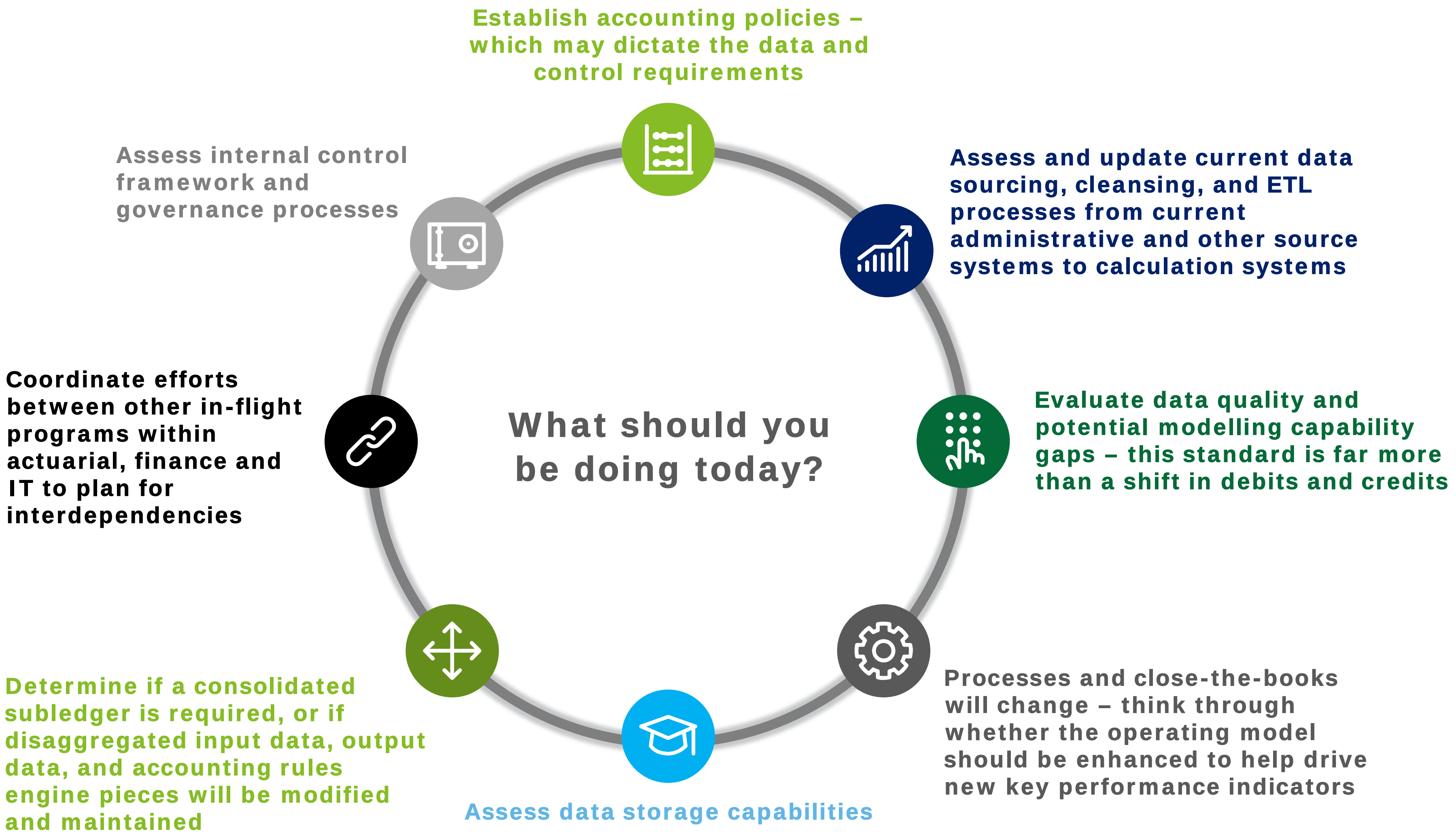
- Basic controls and tracking of data movements is essential
- Necessity to reconcile transaction detail to summary reporting across actuarial and finance functions

Next Steps & Best Practices

Begin organizing project teams today, and determine methods to inventory, organize, and gather data from insurance contracts and develop a path forward to implementation



Learning from other recent accounting and regulatory change, there are known success factors essential to achieving a cohesive and successful implementation of LDTI



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Ailen Okharedia

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ASU 2018-12: Industry update - Progress made to date and important next steps

Presentation by **Ailen Okharedia**
August 26, 2019

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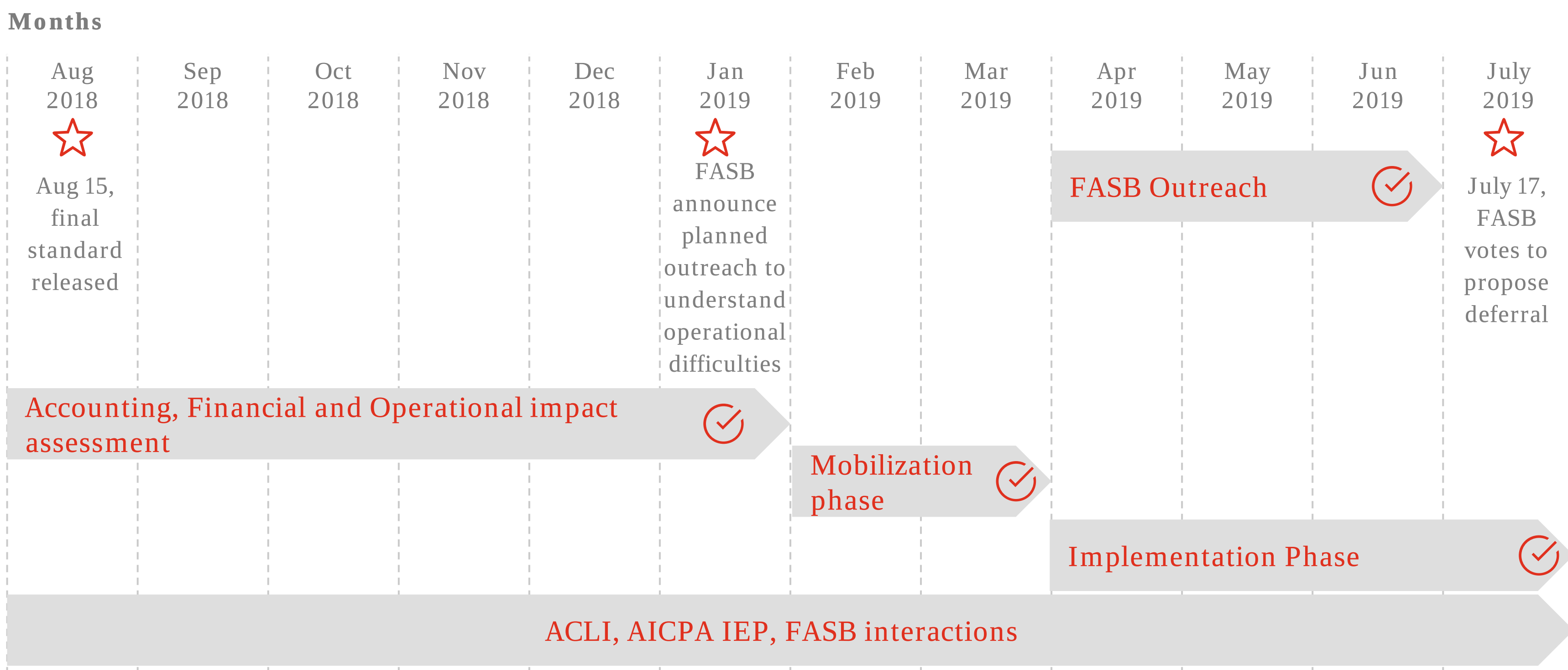
Agenda

1. It has been a busy year for the industry!
2. A framework for accounting policy decisions and deriving initial working assumptions
3 Maximizing the benefits of the proposed deferral

It has been a busy year for the industry!



Initial impact assessment across accounting, financial and operational dimensions began just before or subsequent to the issue of the final standard on August 15, 2018 for a number of insurers

Mobilization phase used to bridge the gap between higher-level impact assessment and a more detailed implementation and execution phase

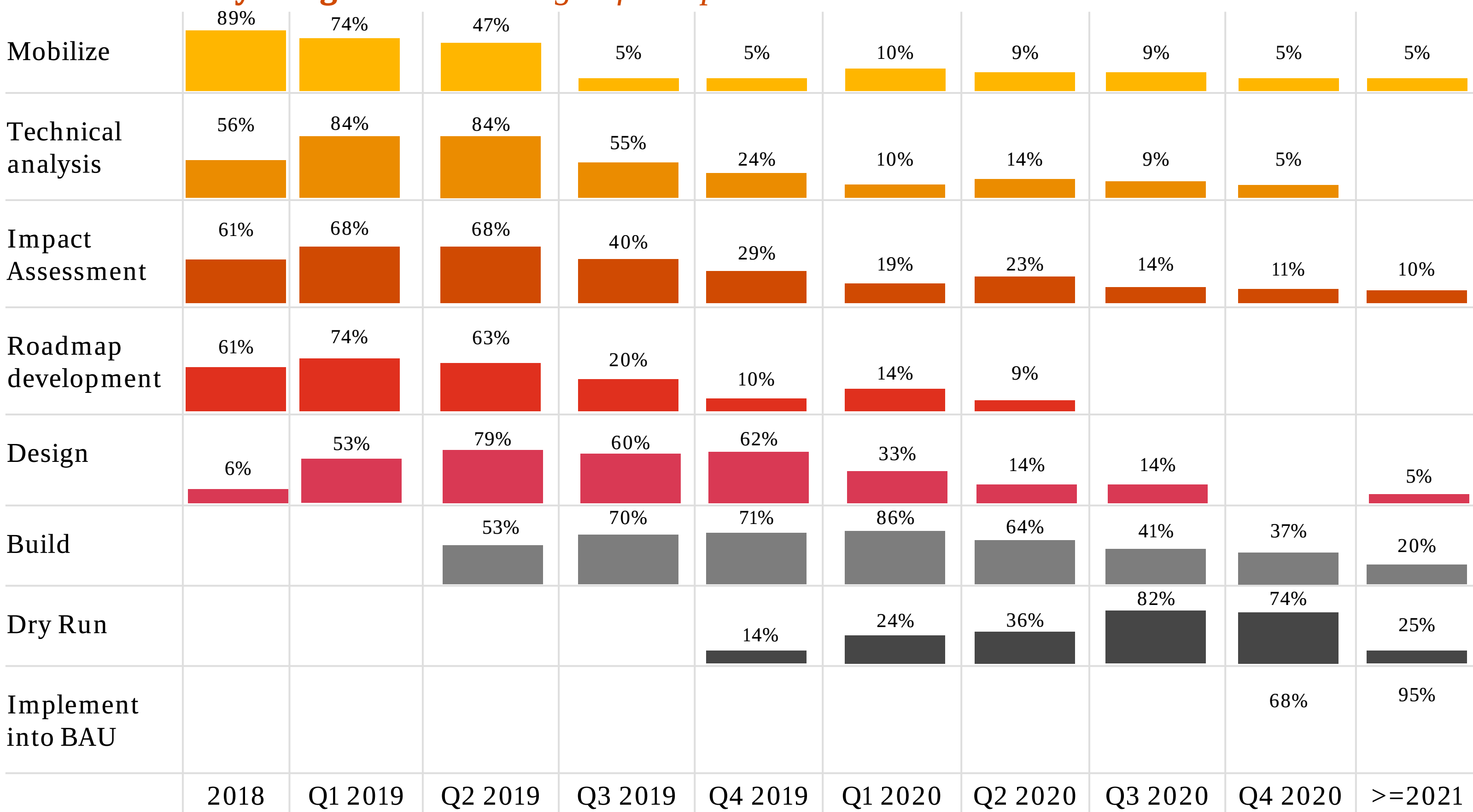
Implementation phase with detailed implementation plan, activities, activity owners and milestones

It has been a busy year for the industry!

The following summarizes the time windows (prior to the proposed deferral) for the different phases where more than half of the companies will be engaged in:

- **Solution design**: Q1 2019 - Q4 2019 ; **Build:** Q2 2019 - Q2 2020; **Dry runs:** Q3 2020 - Q4 2020; **Implementation into BAU**: Q4 2020-2021

Breakdown by Stages – *Percentage of companies*



A framework for accounting policy decisions and deriving initial working assumptions (1 of 2)

Multiple accounting policy decisions and initial working assumptions needed across each accounting topic:

1 Transition

Retrospective; Modified Retrospective

2 Liability for Future Policy Benefits

Unit of Account; Frequency of updating actuals; Claims related expense treatment; Exploration of limited solutioning for Legacy blocks; Loss recognition testing reserves, etc.

3 Deferred Acquisition Costs

Grouped vs. Individual; Amortization base; Amortization period; Experience adjustment methodology; DAC-like balances

4 Discount Rate

Source, Interpolation & Extrapolation, Interest accretion method, Cohort level discount rate, etc.

Accounting Topic Group:

Representatives from Finance, Actuarial and Technical Accounting to analyze specific FASB LDTI topic

External auditor engagement:

Engagement with external auditors for soft sign-off, particularly on significant areas of judgment

Technical Committee:

Reviews and approves recommendations on working assumptions from Accounting Topic Group

Steering Committee:

Sign-offs from Steering Committee for technical accounting with significant strategic or financial impacts

A framework for accounting policy decisions and deriving initial working assumptions (2 of 2)

The following are identified key execution risks from impact assessment work performed to date:

5 Market Risk Benefits — Various MRB topics for consideration

6 Presentation & Disclosure — Level of aggregation, Level of detail (roll-forward line items)

7 Claim Reserves — Scope and treatment AICPA IEP issues

8 Reinsurance — LFPBs, MRBs, Ceded, Assumed, AICPA IEP issues

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Signs-off from Steering Committee for technical accounting with significant strategic or financial impacts

Maximizing the benefits of the proposed deferral (1 of 3)

Replanning and revisions to current plan is needed based on new timelines:

Adjust project plan based on the revised timing

Review auditor engagement models to allow more time for feedback cycles

Increase efforts to develop and execute robust change management and training plans

Develop more robust testing/dry run plans and control frameworks

Maximizing the benefits of the proposed deferral (2 of 3)

The deferral provides an opportunity to ensure better outcomes for an insurer by ensuring sufficient analysis is performed to make informed policy and strategic decisions:

Perform more robust financial modelling to assess impacts of accounting policy decisions on key KPIs

Further assess strategic opportunities created in an LDTI world (e.g. strategic acquisitions/ divestments, product development, hedging etc.)

Allocate more time to think through secondary impacts, e.g. hedging, product development and operating income

Consider the implications on internal and external communications

Maximizing the benefits of the proposed deferral (3 of 3)

The deferral creates an opportunity to use LDTI as a catalyst for modernization:

Revisit strategic modernization opportunities e.g. actuarial platform conversions, process automation and data management improvements

Revisit ability to leverage or accelerate in flight projects to support synergies in delivery

Reconsider opportunities to optimize resources mix and skills (e.g. greater potential to onboard key resources through backfill)

... and most importantly:
Don't lose the momentum!

Thank you

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ASU 2018-12: Implementation Considerations for Market Risk Benefits

Valuation Actuary Symposium

August **26**, 2019

Introduction: What is a Market Risk Benefit (MRB)?

From ASC 944-40: “A contract or contract feature that both provides protection to the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk shall be recognized as a market risk benefit.”

- MRB’s are a new concept under ASU 2018-12. They are recognized at fair value, with changes in fair value recognized in net income, except for changes attributable to changes in instrument-specific credit risk, which are recognized in other comprehensive income.
- Determining whether a contract or contract feature meets the definition of an MRB requires judgment. The effect of capital market risk to both the contract holder and the entity is evaluated to conclude whether a contract or contract feature contains an MRB. [944-40-25-25C]

Implementation Consideration: For many companies, an initial scoping exercise will need to be conducted to identify MRB’s, as some product features do not have an obvious initial answer and will require qualitative and/or quantitative assessments to determine whether they are MRB’s or not.

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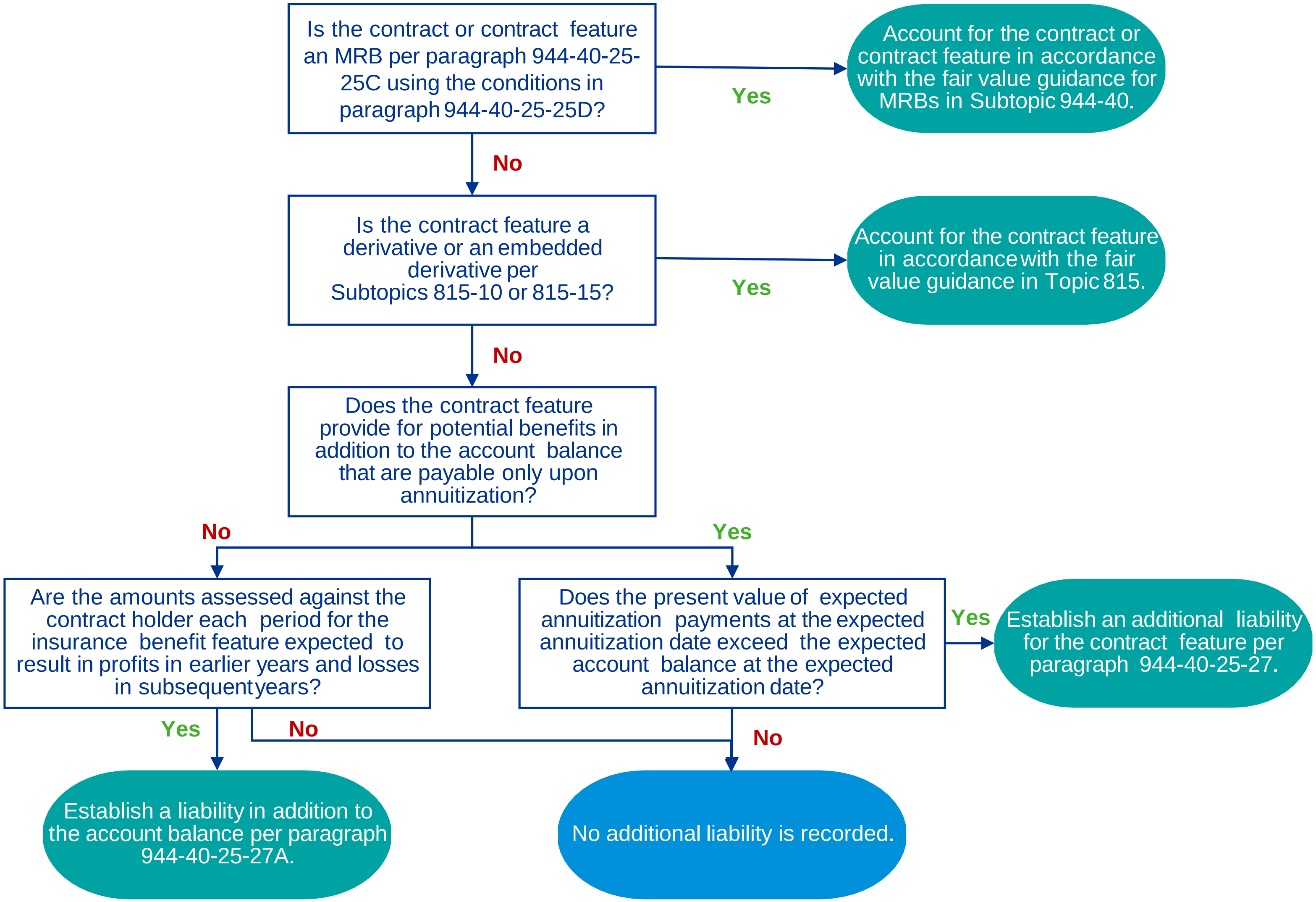
MRB Implementation Consideration #1: Scoping

Scoping Hierarchy and Decision Tree



Scoping of Common Product Features

Features That Meet the Definition of MRB

All guaranteed minimum benefits (GMXB's), including:

- Guaranteed minimum withdrawal benefits
- Guaranteed living withdrawal benefits
- Guaranteed minimum income benefits
- Guaranteed minimum accumulation benefits
- Guaranteed minimum death benefits

The above includes such benefits attached to both variable and fixed products

Features Which Require Analysis

Guaranteed annuitization rate contract features

- Such features are not clearly inside or outside the scope of an MRB
- Companies should analyze whether the capital market risk of the feature is other-than-nominal

Stable value wraps and guaranteed investment contracts (GICs)

- Companies should analyze what is considered to be the account value – i.e., market value or book value

Scoping analysis should be performed using assumptions that would have been used at original issuance

Product Features which are NOT Market Risk Benefits

Equity-indexed component

Does not meet the definition of protection – i.e. does not result in a benefit in addition to the account balance. [944-40-25-25D(b)]

Death benefit – e.g. fixed benefit on a variable life insurance contract

Does not meet the definition of protection – i.e. death benefit component is excluded from scope [944-40-25-25D(b)]

Interest credited, including guaranteed minimums

Does not meet the definition of protection – i.e. does not result in a benefit in addition to the account balance. [944-40-25-25D(b)]

No lapse / secondary guarantee on an insurance contract

Does not meet the definition of protection – i.e. death benefit component is excluded from scope; does not transfer a loss; does not include a capital market component. [944-40-25-25D(a) – 25D(b), 944-40-55-14]

MRB Implementation Consideration #2: Initial Measurement

How are MRB's Measured?

Nonoption valuation approach	Option-based valuation approach
– Often called the 'attributed fee' method. – In general, determine MRB terms to achieve a fair value of zero at the contract inception date (often via a calculated attributed fee). – Generally, there is no immediate earnings effect of initial recognition and measurement. – The attributed fee cannot exceed the total contract fees and assessments collectible from the contract holder or be less than zero. – Once set at inception, generally the attributed fee does not change over the life of the contract. – Subsequently, the fair value calculation represents the present value of future benefits less the present value of the future attributed fees.	– The MRB terms are not adjusted to achieve a fair value of zero at the contract inception date. – The initial carrying amount adjusts to the value of the underlying insurance contract at inception, resulting in no immediate effect on earnings on initial recognition and measurement. – Subsequently, the fair value calculation represents the present value of future benefits.

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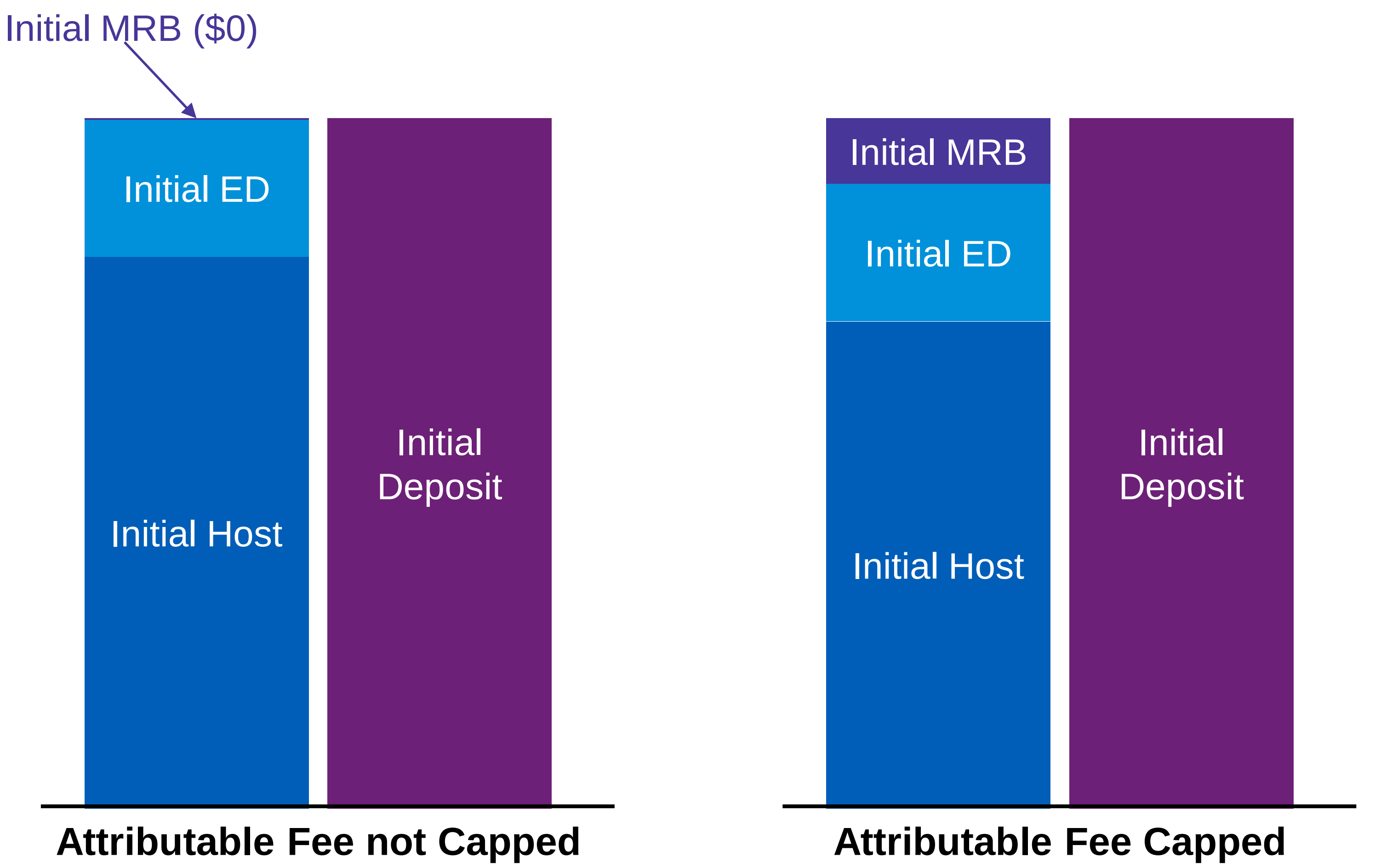
Initial Measurement: Considerations

- The transition method for MRB's is fully retrospective, meaning that if an attributable fee method is used, the attributable fee should be determined as of the original contract issuance date.
  - ASU 2018-12 permits the application of hindsight for assumptions that are unobservable or unobtainable.
  - Hindsight is not equivalent to using actual historical experience information.
- If an attributable fee method is used and such fees are capped by the terms of the contract, the MRB may be nonzero at initial recognition. In this case, the host value would require adjustment so the contract is not lossmaking at issue.
- Multiple MRB's attached to an individual contract are valued as a single compound MRB, which means that all fair value assumptions are considered together.
- The valuation considers the interdependencies between the benefits – e.g. the withdrawal assumptions (GMWB) take into account the payment assumptions (GMDB).

Example: Initial Recognition for a Fixed Indexed Annuity with GLWB



MRB Implementation Consideration #3: Subsequent Measurement

Subsequent Measurement: Changes in Instrument-Specific Credit Risk

- The only specific method identified in Topic 825 for determining instrument-specific credit risk for financial liabilities for which an entity elects the fair value option is the:
  - total change in fair value of a financial liability; less
  - changes in fair value of the financial liability arising from a change in a base market risk, such as a risk-free rate or a benchmark interest rate. [825-10-45-5]
- Alternatively, an entity can use another method if it results in a fair representation of the total change in fair value resulting from a change in the instrument-specific credit risk. [825-10-45-5]
- The change in the instrument-specific credit risk is the portion of the change in fair value that excludes the amount of the change resulting from a change in the base market rate - e.g. risk-free rate or benchmark interest rate. Alternatively, an entity may use another method to determine the change in the instrument-specific credit risk. The method used is a policy election that should be disclosed and consistently applied. [825-10-45-5]

Subsequent Measurement: Derecognition

- When a contract is extinguished, an MRB is derecognized in the financial statements. At this time, an entity records in income any amounts previously recorded in AOCI – e.g. changes in instrument-specific credit risk. [944-40-35-8B]
- For contracts with an annuitization option, from an accounting perspective the: [944-40-35-8B]
  - date of annuitization represents the end of the initial contract; and
  - payout phase represents a new contract.
- The MRB is derecognized at the date of annuitization. At that time, any amounts previously recorded in AOCI for changes in instrument-specific credit risk related to the insurance entity's nonperformance (that is, the settlement or extinguishment of an obligation for an amount less than the contractual obligation amount) are recognized in earnings. [944-40-35-8B]
- The date of annuitization is also the inception date of a new distinct accounting contract representing the payout phase of the underlying contract. [944-40-35-8B]

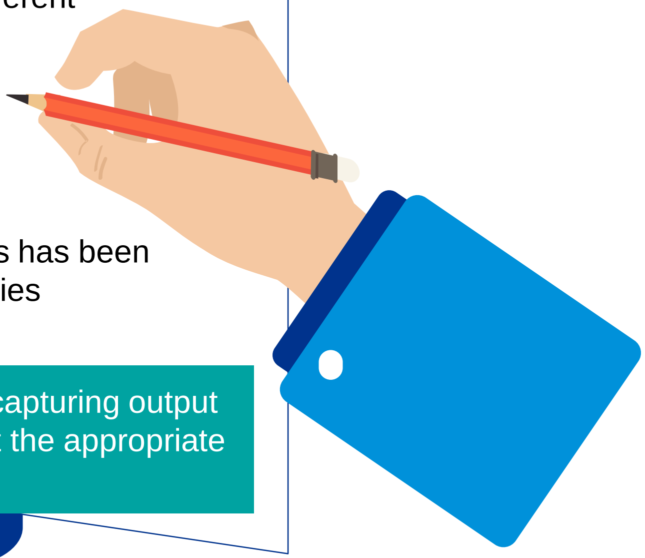
MRB Implementation Consideration #4: Disclosure Requirements

Disclosure Requirements and Principles Under ASU 2018-12

ASU 2018-12 requires disaggregated disclosures for market risk benefits, including rollforwards of opening and closing balances and quantitative and qualitative information about significant inputs, judgments and assumptions used in measurement.

— ASU 2018-12 provides:
  - a principle for determining how to disaggregate the new disclosures to provide meaningful information without requiring a large amount of insignificant detail or aggregation of items with significantly different characteristics
  - examples of disaggregation characteristics (e.g. type of coverage, etc.)
  - clarification that the aggregation of the disclosures would at a minimum be consistent with segment-related disclosures

— Entities should consider how information about market risk benefits has been disaggregated for other purposes when determining which categories would be the most relevant and useful



Implementation Consideration: Companies will need to think about capturing output that allows for all of the required disclosures to be populated at the appropriate level of aggregation.

Market Risk Benefit Example Disclosure

944-40-50-7B(a)
944-40-50-7B(b)

	December 31, 2021		December 31, 2020		December 31, 2019	
	Variable annuities	Fixed Indexed annuities	Variable annuities	Fixed Indexed annuities	Variable annuities	Fixed Indexed annuities
Balance, beginning of year	$ -	$ -	$ -	$ -	$ -	$ -
Balance, beginning of year, before effect of changes in the instrument-specific credit risk	$ -	$ -	$ -	$ -	$ -	$ -
Issuances	$ -	$ -	$ -	$ -	$ -	$ -
Interest accrual	$ -	$ -	$ -	$ -	$ -	$ -
Attributed fees collected	$ -	$ -	$ -	$ -	$ -	$ -
Benefit payments	$ -	$ -	$ -	$ -	$ -	$ -
Effect of changes in interest rates	$ -	$ -	$ -	$ -	$ -	$ -
Effect of changes in equity markets	$ -	$ -	$ -	$ -	$ -	$ -
Effect of changes in equity index volatility	$ -	$ -	$ -	$ -	$ -	$ -
Actual policyholder behavior different from expected behavior	$ -	$ -	$ -	$ -	$ -	$ -
Effect of changes in future expected policyholder behavior	$ -	$ -	$ -	$ -	$ -	$ -
Effect of changes in other future expected assumptions	$ -	$ -	$ -	$ -	$ -	$ -
Balance, end of year, before effect of changes in the instrument-specific credit risk	$ -	$ -	$ -	$ -	$ -	$ -
Effect of changes in the instrument-specific credit risk	$ -	$ -	$ -	$ -	$ -	$ -
Balance, end of year	$ -	$ -	$ -	$ -	$ -	$ -
Less: Reinsurance recoverable	$ -	$ -	$ -	$ -	$ -	$ -
Balance, end of year, net of reinsurance	$ -	$ -	$ -	$ -	$ -	$ -
Net amount at risk[(a)]	$ -	$ -	$ -	$ -	$ -	$ -
Weighted-average attained age of contract holders	XX	XX	XX	XX	XX	XX

(a) For those guarantees of benefits that are payable in the event of death, the net amount at risk is generally defined as the current guaranteed minimum death benefit in excess of the current account balance at the balance sheet date.

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For further examination over ASU 2018-12, please refer to KPMG's detailed handbook at https://frv.kpmg.us/reference-library/2019/handbook-long-duration-insurance-accounting.html

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates.

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