LDTI ACCOUNT POLICY DECISIONS

ASNY ANNUAL MEETING

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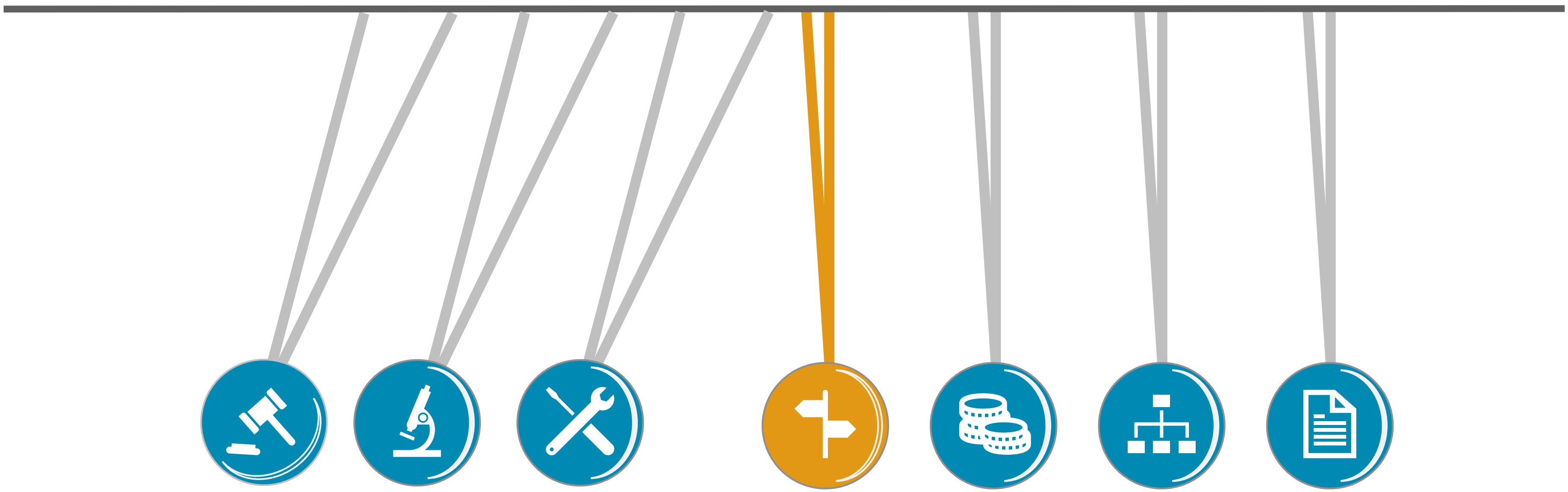
Public life insurers have about two years until GAAP LDTI goes live

Companies are at various implementation stages and stages naturally recoil between each other



ASU 2018-12
Adopted 8/2018
Effective 1/2022
for large SEC filers

Awareness
Education, interpretation, auditor involvement

Development
Models, assumption database

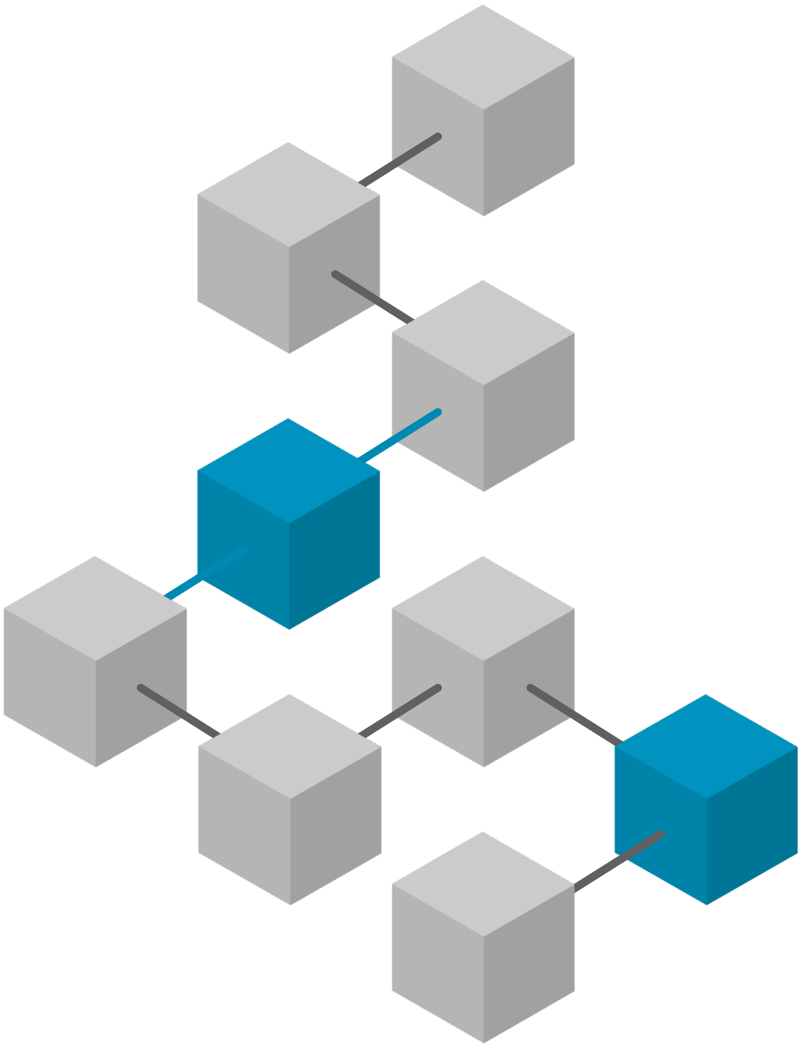
Transition
Evaluating options and comparative financials

Management
Pricing, hedging, rate setting

Processes
Assumption governance, valuation procedures and controls

Reporting
Disclosures, investor day readiness, operating earnings

Selecting the best accounting elections involves multiple connected considerations



Considerations

Weighed differently at each company

- Ability to analyze and explain financials
- Auditor opinion
- Consistency with industry peers
- Congruence with risk and ALM practices
- Earnings emergence and volatility
- Financial reporting close speed
- Implementation cost and time
- Non-GAAP adjusted earnings production
- Precision and complexity
- Software support

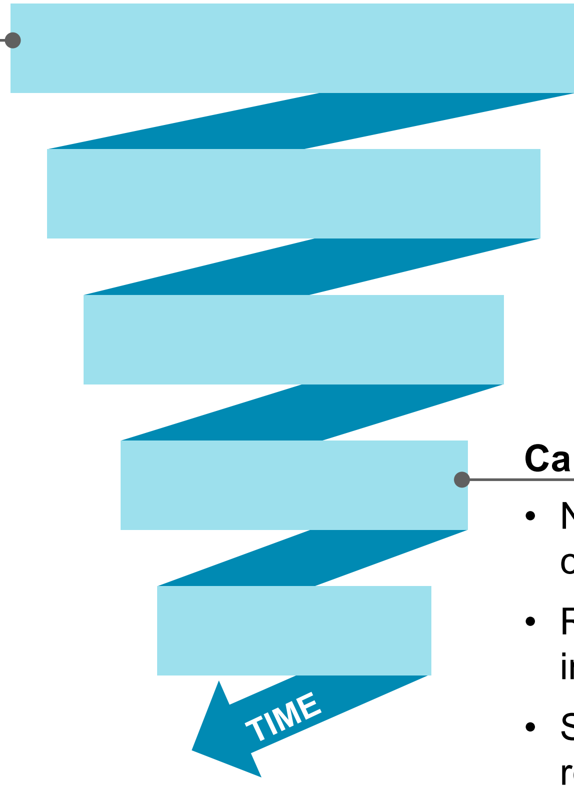
GAAP Long Duration Targeted Improvements objectives
Revisions to simplify and enhance financial reporting

1. **Simplify amortization of deferred acquisition costs**
2. **Improve timeliness by recognizing changes in expected traditional and limited pay future liability payments**
3. **Simplify reporting of market-based guarantees through consistent fair value accounting**
4. **Enhance effectiveness of required disclosures**

Capitalized costs now recognized using "straight-line amortization"

Amortization

- Amortized over expected term without interest
- Performed at individual contract level or may be grouped as long as it approximates individual
- Negative experience variance must be recognized immediately, positive are optional
- Assumption revisions recognized prospectively
- Shadow DAC no longer applies
- No longer subjected to impairment testing



Capitalization

- No change to definition of what's capitalized
- Recognized for capitalization only after incurred
- Sales inducements and unearned revenue treated similarly except in scope for impairment testing

Liability changes for traditional and limited payment contracts

		Financial line item impacted	Targeted improvements	Prior standards
1	**Assumptions**	Earnings as re-measurement	• Best estimate assumptions with no PADs • At least annual review of assumptions with unlocking	• Original assumptions with PADs locked-in at issue
2	**Discount rate**	Other Comprehensive Income	• Upper-medium grade fixed-income instrument yields updated quarterly • Original discount rate part of all future calculations	• Similar to other assumptions, locked-in at issue • Based on company's earned rate
3	**Premium sufficiency**	Earnings	• Excludes maintenance expenses • Original rate discounting • Sufficiency test at cohort level through net premium ratio 100% cap	• Includes maintenance expenses • Impairment testing performed at the aggregate block level including DAC

Traditional and limited pay liability decisions
Significant changes are coming for lines with historical stability

Reinsurance separate

LDTI makes no explicit change to reinsurance accounting guidance which many interpret as meaning many changes including potentially updating all associated assumptions

Assumption revisions

Unlocking introduces volatility that evokes credibility threshold, study tempo, reset procedures and SoX compliant governance considerations

Unlocked discount rates

Remeasurement for rate changes makes other comprehensive income more insightful to analysts, which motivates a thoughtful definition of “upper-medium grade” and how to extrapolate beyond observable data

Aggregation

Judgement within “no less frequently than issue year and similar products” criteria allows weighing capping of net premiums, reserve flooring, earnings emergence and calculation complexity

Transition approaches

While modified retrospective is most commonly used, single line insurers with good data are considering full retrospective because it may produce beneficial transition day adjustments

Historical data

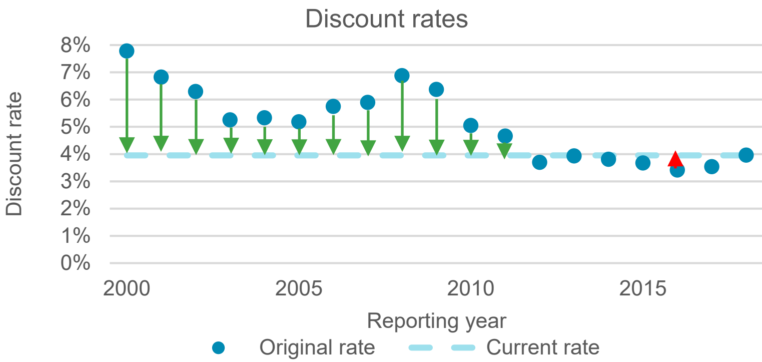
Traditional liabilities were often set-and-forgotten long ago (e.g., factors on old mainframes), industry accepted practices such as inferred deferred profit liabilities make for some practical problems to resolve

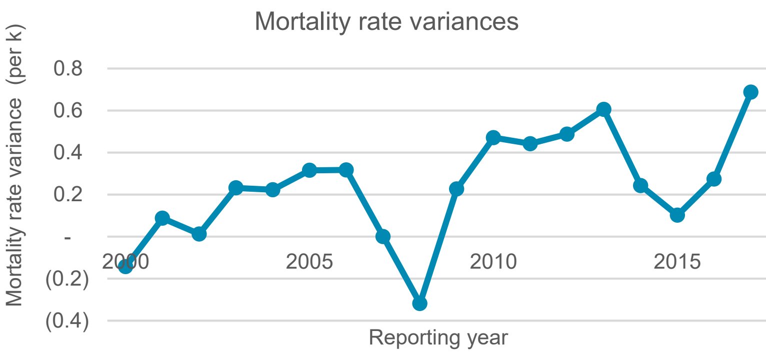
Locked-in discount rates

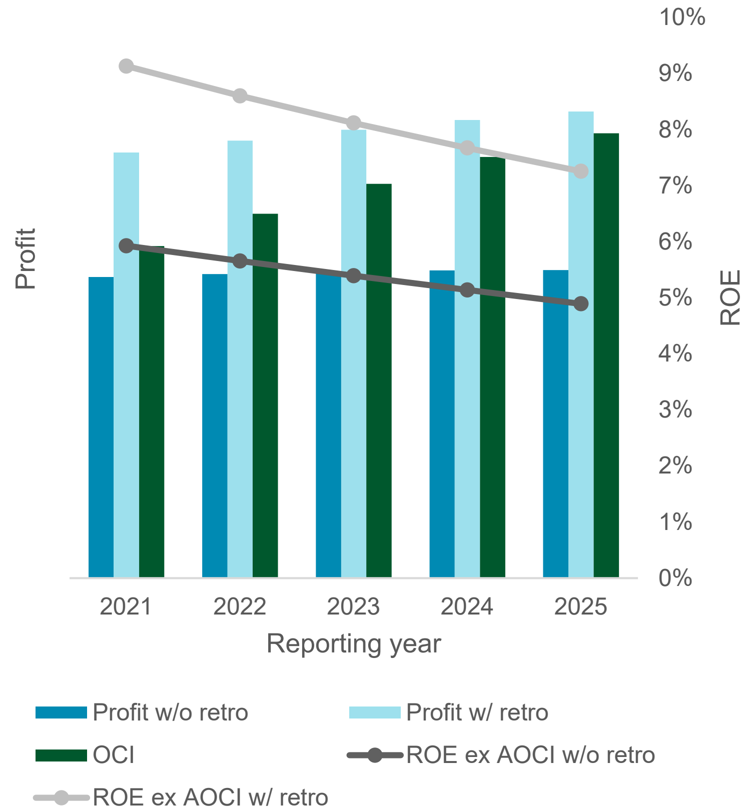
Original discount rates used for future policy benefit liability changes recorded in income may take the form of forward rates, spot rates, or single flat rates – with each form having different earnings pattern / alignment with investment income

Retroactive restatement is a onetime opportunity to reset the balance sheet

Example: true-up of adverse mortality and discount rates could produce higher future profits and OCI

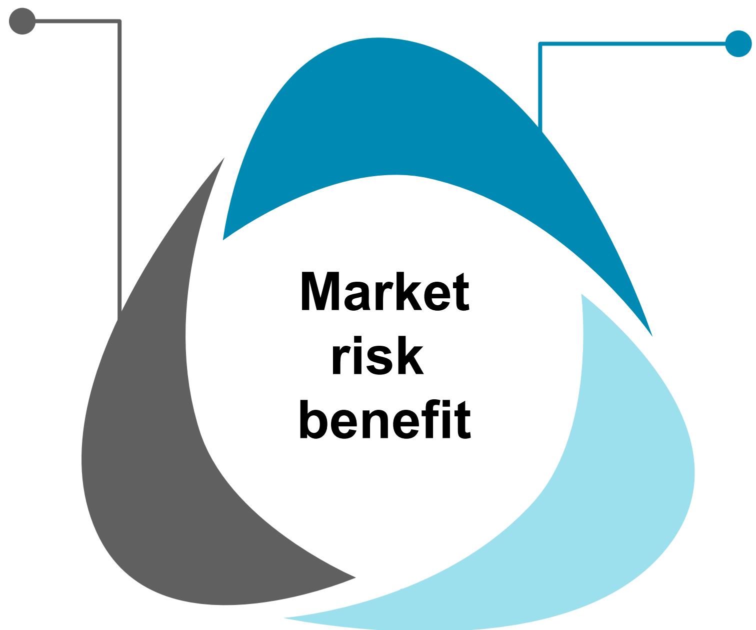






Since retroactive reserve increase due to actuarial assumption revision is recorded through retained earnings, restatement may lead to higher future profits and ROE

Market risk benefit definition



Provides protection

- Any transfer of a loss in account balance from the contract holder to the company
- Does not include death benefit component of life insurance
- Does apply to death benefit coverage of investment and annuity contracts

Other-than-nominal

- More than remote probability of occurring determined at inception
- Analysis of stochastic scenario tail results most common
- Generally measured without discounting and net amount at risk without election incidence rates considered

Capital market risk

- Equity, interest rate, and foreign exchange risks

Market risk benefit decisions

Fair value brings calculation decisions and some motivation to test scope

Classification and approach

All market risk benefits are valued together classified as a stand-alone derivative, option type or non-option type. After classification is made approaches may involve full fair value, ascribed fee, or swap method

Market consistency

Margins may be explicit or implicit, own credit may not apply to fees or asset positions, illiquidity may be recognized, behavior and crediting may adjust under risk neutral valuation, etc.

Reinsurance separate

Ceded risks are valued separately from direct contracts based on date of cession and reflecting credit risk of the reinsurer, which can cause mismatch

Scope

Companies are testing some guarantees such as annuitization guarantees for insignificance to get them out of scope

Bifurcation

Market risk benefits are separated from the host and embedded derivatives, which may leave subtle and complex decisions such as choosing equity indexed annuity cash flows to trifurcate

Measurement

For guarantees classified as options and non-option classes with insufficient fees an initial non-zero balance will need to be recognized over the life of the contract and opinions vary on the right approach

Historical data

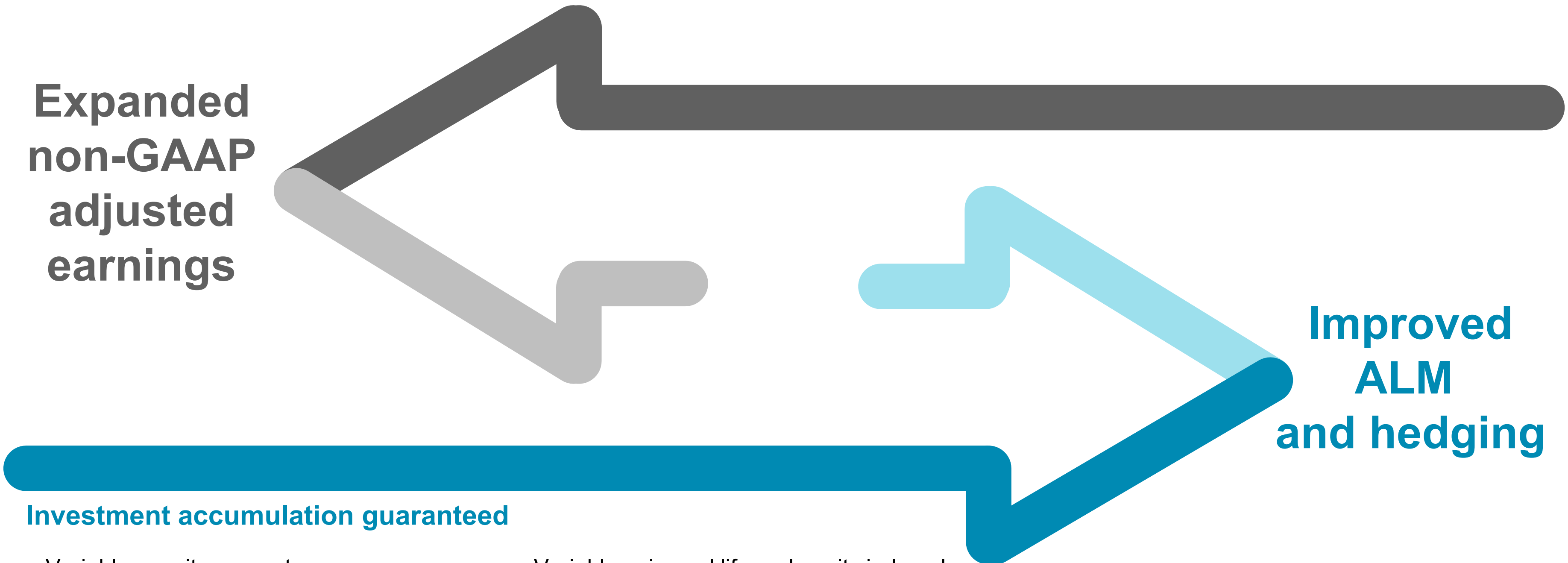
Calibration of ascribed fees and non-zero initial balances are required to be set at inception without foresight, which can be difficult if data is missing leading to conversations with auditors

Market risk benefit scope

In some cases changing toward fair value is a welcome alignment with hedging / risk management but not always

Insurance protection continued

- Material annuitization pay-out guarantees
- Variable universal life no-lapse guarantees
- Disability and health benefits that continue after variable no-lapse guarantees



Investment accumulation guaranteed

- Variable annuity guarantees
- Non-accumulation equity indexed annuity guarantees
- Structured annuity guarantees
- Variable universal life and equity indexed universal life account balance and withdrawal guarantees
- Stable value elements of corporate and business owned life insurance

Financials will become significantly more transparent

Quarterly disclosures

- Disaggregated year-to-date roll-forward of liability for future policy benefits, policyholder account balances, MRB's and DAC, reconciled to balance sheet
- Actual experience during the period compared to expected
- Amount of revenue and interest recognized
- Related reinsurance recoverable
- Weighted average liability duration
- Weighted average interest rate and method used

Additional annual disclosures

- Nature of deferred acquisition costs, information about inputs, assumptions, judgement, and methods used to determine amortization, and changes in those items
- Information about significant inputs, assumptions, judgement, and methods used in measuring traditional liability and MRB, changes to these items during the period, and the effect of those changes on measurement

Other reporting considerations

- Liability remeasurement is a new line in the income statement, separate from disclosures in the notes
- Market risk benefits presented separately on the balance sheet and income statement with instrument specific credit risk below the line
- Qualitative and quantitative information about transition adjustments to retained earnings and AOCI, net premiums exceeding gross premiums, and premium deficiencies

Expanded and auditable actuarial inputs to financials require stronger infrastructure

Disclosure decisions

What's the "goldilocks" level of information and how best to produce it are the key disclosure decisions

Suggested vs. required

High level requirements are set such as roll forwards that tie to the balance sheet are clearly required, but illustrations of content are suggestions that may or may not need to be followed closely

Liability for future policy benefits

In addition to aggregation and the several decisions behind the exact approach for roll forwards, companies need to decide on how to measure weighted average duration

Deferred acquisition costs

Interpretation of "straight-line" has been a significant challenge for actuaries and may be even harder to explain to analysts in the disclosures. Other challenges include how exactly to construct the roll forwards and what to say on costs deferred

Infrastructure

The needs to compile multiple runs to make roll forwards, deal with software that may not follow the approach wanted, and multiple software vendors among lines all need to be considered when deciding what should be done "native" or "external" to your actuarial projection software

Net premium sufficiency

Qualitative and quantitative information of net premiums capped at gross premiums is required, but there is no prescribed content of the disclosure and may only be required in the period the event first occurs

Account balance information

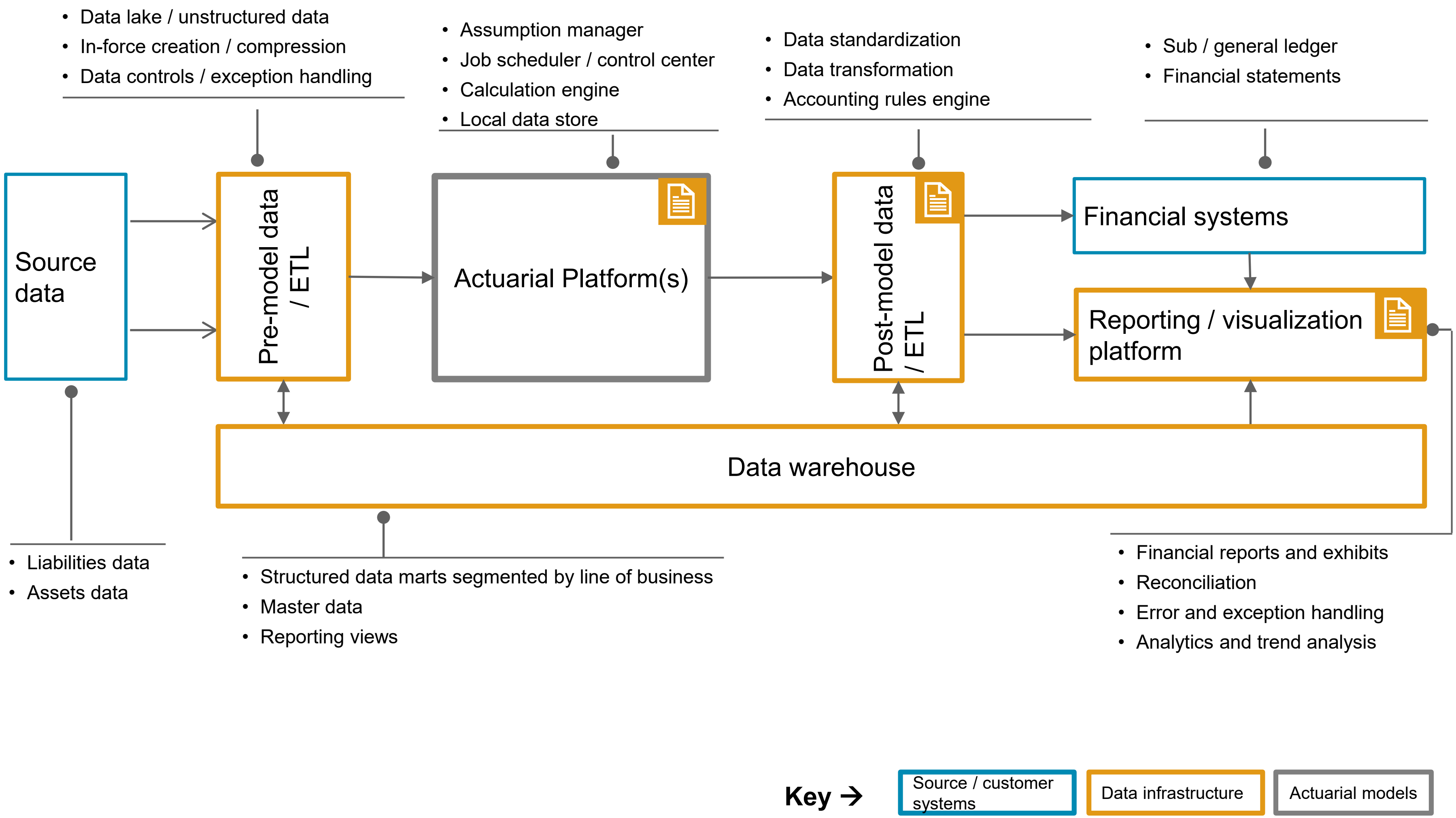
Level of aggregation will determine how insightful disclosures on weighted average credit rates and guarantees will be

Transition and comparative financials

Transition disclosures that explain transition adjustments to retained earnings and AOCI can be misunderstood when scrutinized if not presented clearly. Both these adjustments and the comparative financials are big news for the investor day when executives announce financials under the new standards

Typical financial reporting architecture

Where to perform disclosures – "native" vs. "external" procedures depends on how a company is set up and what is prioritized



QUALIFICATIONS, ASSUMPTIONS AND LIMITING CONDITIONS