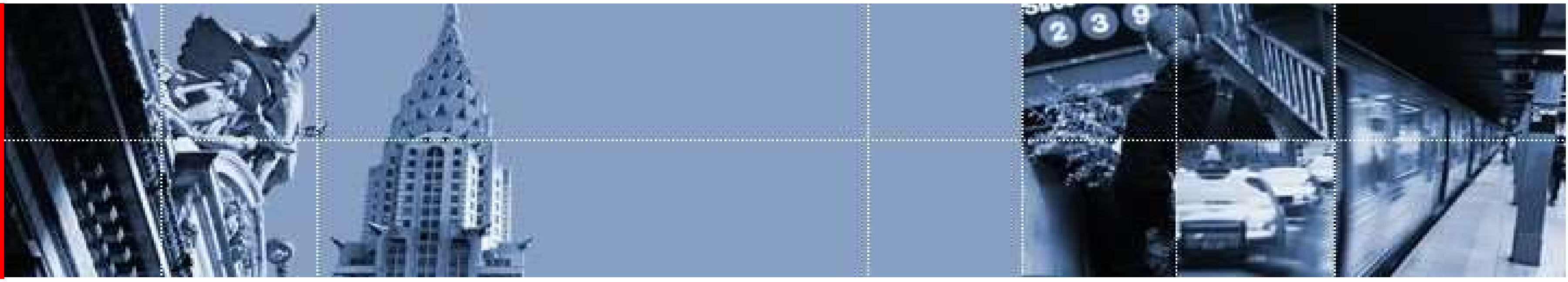

US GAAP LDTI

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LDTI impacts to equity and earnings volatility and how to mitigate them

Jack Zheng, FSA, MAAA

LDTI lessons learnt during implementation

Sarah Valani

Presenters

Jack Zheng

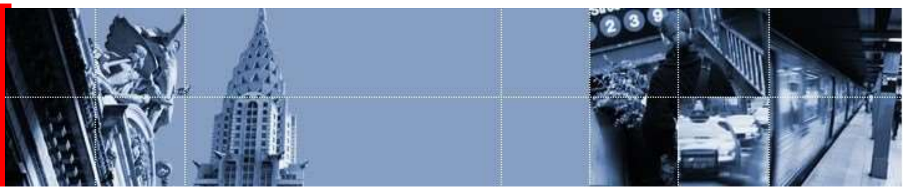
Jack is a consulting actuary with the Insurance and Actuarial Advisory Services practice of Ernst & Young LLP. He is based in New York. Jack has had a number of engagement experiences in financial reporting and model validation. He is a Fellow of the Society of Actuaries.

Sarah Valani

Sarah is a Co-Founder & Actuarial Consultant at Valani Global, where she uses her skills and dedication in projects involving Moody’s RiskIntegrity for LDTI and IFRS 17, AXIS, software conversions and other actuarial transformations.

Agenda

- LDTI Background
- Traditional and Limited Pay
- Annuities (Variable Annuity, Fixed Index Annuity, and Registered Index-Linked Annuity)
- Annuities and Universal Life
- Implementation Lessons Learnt



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LDTI Background

- In August 2018, the FASB issued ASU 2018-12, *Targeted Improvements to the Accounting for Long-Duration Contracts* (commonly referred to as LDTI)
  - One of the most fundamental updates to life insurance and annuity accounting in 30 years
- ASU 2018-12
  - Changes how long duration contracts are calculated and accounted for
  - Creates additional disclosures aimed to help investors to better understand the financial position and financial performance of an insurance company as well as its underlying lines of business
- Adoption required in 2023 for public business entities and a transition date of January 1, 2021
  - Investors of insurance companies will quickly need to reset their expectations of the companies' financial position, profitability, and income volatility that they had become accustomed to prior to the introduction of ASU 2018-12
- Major accounting changes introduced by ASU 2018-12
  - Measurement of liability for future policy benefits (LFPB) using current high-quality fixed-income instrument (i.e., Single A-rated) yield
  - Retrospective recalculation of the net premium ratio (NPR) reflecting experience variances and assumptions update
  - More simplified deferred acquisition cost (DAC) balances calculation and amortization
  - Fair value measurement of market risk benefits previously accounted for under SOP 03-1

Traditional and Limited Pay

Exposure to Assumption Changes

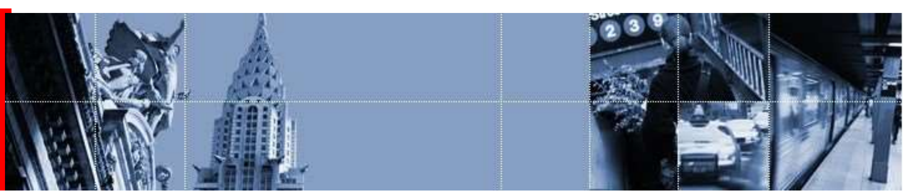
– Best estimate assumptions are required to be used in the measurement of the liability at each reporting date

Impact:

- As assumptions are updated, earnings volatility will ***increase***

Mitigation:

- For traditional products → volatility is ***partially absorbed*** by the NPR
- For Limited pay products → volatility is ***deferred*** by profit liability (DPL)
- To limit significant assumptions changes in each period → management should review and update assumptions periodically



Traditional and Limited Pay

Mitigation of Experience Variances

Mitigation of Experience Variances

– The NPR is unlocked retrospectively back to issue (or transition to reflect experience variances.

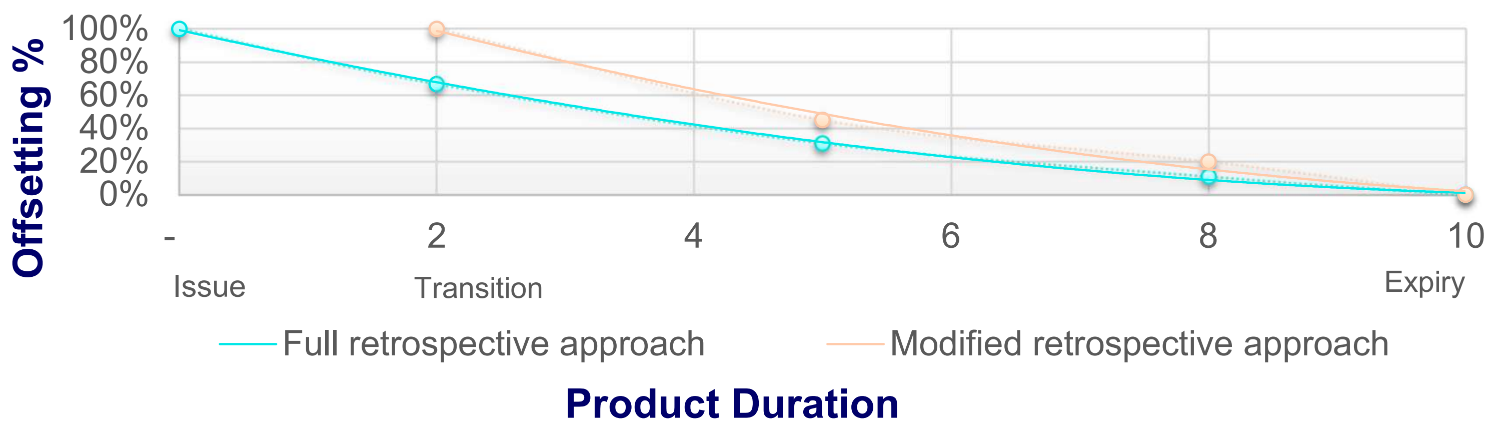
Impact:

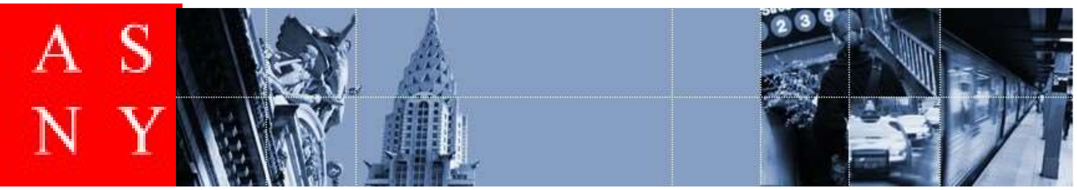
- The introduction of the unlocked NPR will ***reduce*** earnings volatility resulting from experience variances

Mitigation:

- None required

Degree of Offsetting Provided by NPR on Traditional Products





Traditional and Limited Pay

Introduction of Other Comprehensive Income (OCI) from Reserve

Introduction of OCI from reserve

- The LFPB is measured using current market rates at each reporting date
- The impact of changes in market rates are reported in OCI

Impact:

- GAAP equity will now be sensitive to market conditions from the liability → it will offset the sensitivity seen in available-for-sale assets
- In many cases, it will over-correct for the assets due to longer duration liabilities

Mitigation:

- Improved ALM function and improved analytics explain movements in GAAP equity

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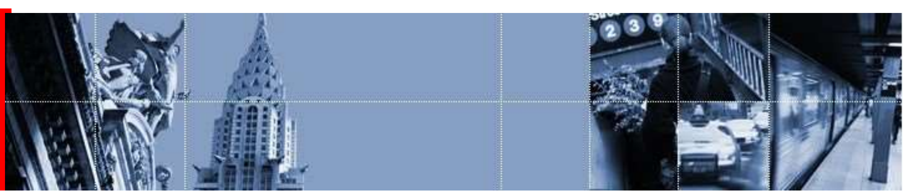


Traditional and Limited Pay
Transition Equity

Transition Equity

– The reported liability on the balance sheet is using the Single-A yield at the reporting date

Impact:

- For most companies, the single A rate at the transition date (January 1, 2021) will be **lower** than the discount rate currently used to measure the GAAP liability → results in an unfavorable equity impact at transition
  - Companies writing long tailed business (ex. Long term care) are particularly sensitive to this

Annuities (Variable Annuity, Fixed Index Annuity, and Registered Index-Linked Annuity)

Expanded Coverage of Fair Value and Transition Equity

Expanded Coverage of Fair Value

– ASU 2018-12 introduces the concept of market risk benefits (MRBs), which expands the range of product features applying fair value

Impact:

- Due to the use of fair value and because the fair value framework does not have an unlocked ratio (like SOP 03-1) to buffer any of the movement → earnings volatility ***increases***

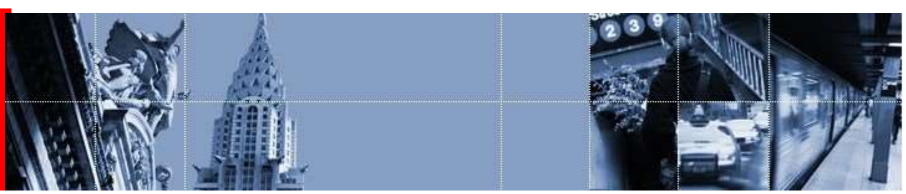
Mitigation:

- Potentially expanded use of hedging to align with MRB
- Expanded use of non-GAAP measures

Transition Equity

– Transition for MRBs will be fully retrospective

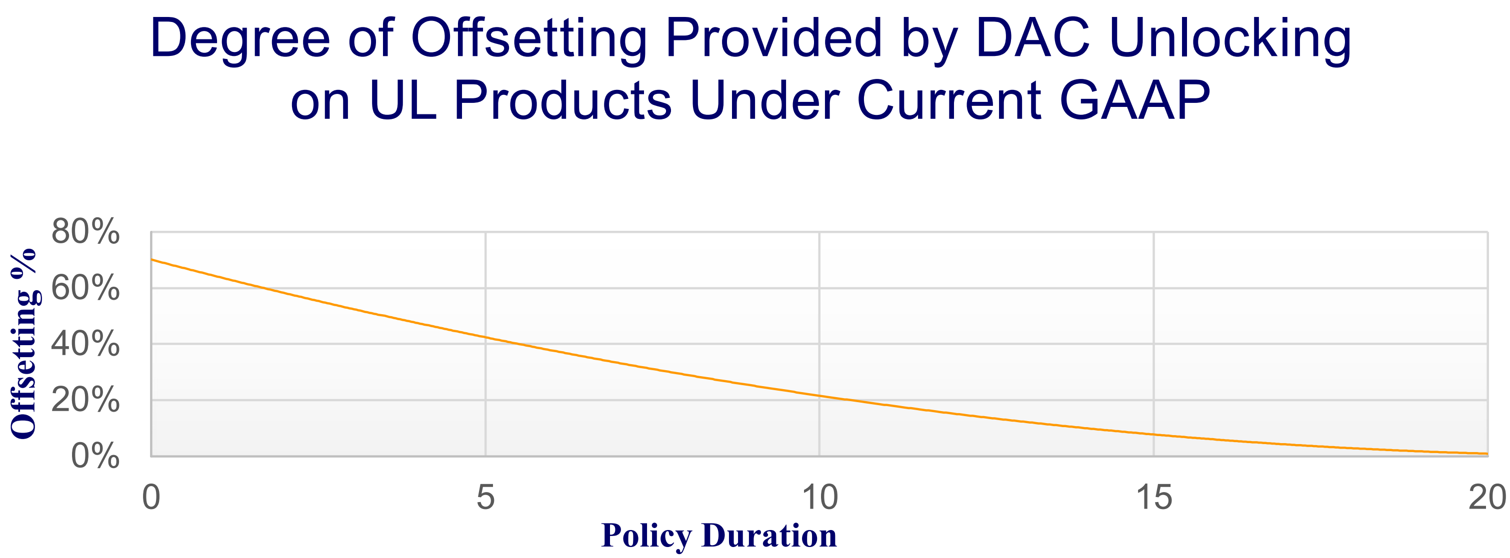
– For products that are currently following SOP 03-1, the equity impact at transition can be in either direction depending on market conditions at that point in time



Annuities and Universal Life
Removal of DAC/URR/SIA Buffering

Removal of DAC/URR/SIA buffering

– Under the current US GAAP accounting, the retrospective calculation of DAC was able to partially offset claims variances. The simplified calculations under ASU 2018-12 remove this effect, increasing overall earnings volatility for these products



The figure above shows that the degree of offset provided by unlocking of DAC under current GAAP is highest near contract issue (where the offset percentage is equal to the net k-factor), and the offset percentage decreases steadily over the life of the contract.

LDTI Implementation Lessons Learnt- Poll

In the chat box:

- Are you an early adopter (2023) or other entity (2025)?
- Where are you in your LDTI journey?
  - Exploring
  - Planning & Resourcing
  - Implementing
  - Analysis
  - Operational
- What major obstacle(s) have you encountered?

LDTI Implementation Lessons Learnt

- Close collaboration between teams
- Data transformation and management
- Actuarial model updates & process automation
- End-to-end solutions for LDTI
- Explaining key drivers of LDTI results
- Governance
- Project management
- Resource constraints
- Resource training

Questions ?