LDTI proposed deferral: Making the most of additional time

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New timeline presents opportunities, challenges

Insurers may receive extra time to implement a significant accounting change, thanks to a vote by the Financial Accounting Standards Board (FASB) on July 17, 2019 to propose deferring the effective date of the Targeted Improvements to the Accounting for Long-Duration Contracts standard (LDTI)[1]. If adopted, the deferral gives insurers more time to comply— a 1-, 2- or 3- year extension, depending on the type of entity.

The deferral news has been hailed by many filers that still have significant work to do ahead of adoption. LDTI fundamentally changes how insurers recognize, measure, present and disclose contracts that provide coverage over an extended period, such as life insurance, disability, long-term care, and limited annuities or payout annuities. LDTI has a vast impact on data requirements, systems, processes, operations and internal control. As a result, insurers have struggled to develop workable timelines for adoption,

LDTI effective dates[1]

Company type	Current effective date for calendar year-end companies	Proposed effective date for calendar year-end companies
SEC filers that are not smaller reporting companies[2]	January 1, 2021	January 1, 2022
SEC filers that are smaller reporting companies	January 1, 2021	January 1, 2024
Public business entities that are not SEC filers	January 1, 2021	January 1, 2024
All other companies in the scope of ASC 944	January 1, 2022	January 1, 2024

"The FASB's deferral is needed by many insurers which—despite concerted efforts to meet the deadline—felt they could not realistically implement such a complex and costly accounting change under a tight timeframe. Field visits to a dozen insurers, as well as comment letters from individual companies and trade groups, helped the FASB recognize the industry's significant implementation concerns and contributed to the proposal to defer."

Michael Lammons,
Partner, Accounting Advisory Services, KPMG LLP

[1] Defining issues, July 18, 2019
[2] See the definition of a smaller reporting company on SEC Release Nos. 33-10513; 34-83550, Smaller Reporting Company Defintion

particularly related to the time required to implement automated system solutions. As a result, many leading insurers and industry groups lobbied FASB for the extension.

As can be expected, the implementation effort must continue and the deferral will likely extend current implementation plans. Insurers at every stage of adoption will need to reassess and readjust their implementation strategy and roadmap to fit the revised implementation timeline. This could present some practical opportunities, especially for insurers that are presently pursuing stop-gap solutions.

How to make the most of the extension

Despite the challenges, the longer timeline presents significant opportunities. For some insurers, it provides valuable additional time to assess the impact of LDTI, update controls, test solutions and work through implementation challenges and complexities. For others, it's a chance to leverage the new standard as a catalyst for strategic changes—to jumpstart finance and actuarial transformations, and drive greater efficiency, transparency and value within the businesses.

Now, with deferral likely, insurers face a host of difficult decisions. How should they use the extra time? Where should they focus their efforts? What priorities should be at the top of the agenda?

Based on our work with insurers impacted by this accounting change, we've identified several key areas of focus over the next one to three years. By prioritizing these actions during implementation, insurers can best take advantage of the extra time to prepare for compliance as well as achieve long-term strategic and operational benefits.

1 Reassess the implementation plan.

Insurers' key decisions about what activities to prioritize, where to invest resources, and evaluation of transition options may have been influenced by the original effective date and the limited time to adopt the standard. But the deferral changes what is both practical and possible for insurers to accomplish on the path to adoption. Now is the time to reconsider previous decisions to ensure they are still appropriate and strategic—especially costly or resource-heavy activities that were pursued primarily for the sake of speed. In reevaluating the implementation roadmap, organizations should consider prioritizing activities that fit into the new timeline and bring immediate value. This may include an evaluation of "no regrets" activities - particularly in the earlier stages of the implementation process

> "Even with the adoption deferral, implementing LDTI is a major undertaking for insurers. Gathering the required data for enhanced disclosures and updating models for calculating reserves requires an overhaul of enterprise wide systems and processes, from finance to actuarial to internal controls."
>
> **Laura Gray,** *Principal, Actuarial, KPMG LLP*

2 Reconsider missed strategic opportunities.

Now is the time to assess progress to date against the original implementation plan and consider whether certain more strategic activities should be added to the timeline - particularly if those activities were originally excluded based on difficulties related to the original timeline. This is especially important for insurers that—in a rush to be compliant by 2021—have been planning for short-term tactical fixes, or are on a journey to apply the bare minimum requirements. As a caution, we've also observed significant internal control and additional issues related to other recent standard changes where companies adopted a bare bones tactical approach. Additionally, LDTI adoption can be a catalyst for system and process improvements—or even for more total finance and actuarial transformations. For example, insurers may be able to automate manual processes or incorporate more data and analytics into their finance and actuarial functions as part of the extended implementation effort. Extra time also gives insurers the opportunity to consider the impact of LDTI on various business and operational areas, such as reinsurance, product design, pricing, asset liability management, corporate development, and performance management.

3 Perform more testing and parallel runs.

The breadth of changes under LDTI will require multiple rounds of testing and calibration before results are ready to be shared with external stakeholders. Previous implementation plans may have only had time for one or two quarters of parallel runs. But with the extended deadline, insurers may have time for additional quarters of testing and parallel runs. The additional time may be spent on designing, testing and implementing controls around revised and new processes. Insurers may also spend more time developing their "story" to explain the impact of adoption and any changes in results. With a longer window to work through challenges that inevitably result from accounting change, insurers can gain confidence that their tools, processes, people and stakeholders are prepared for implementation.

4 Gain greater control of external data.

LDTI will have a substantial impact on insurers' data and information needs. Organizations should consider using the additional time provided by the deferral to work with external parties to fine-tune how the business gathers, manages and reports data sourced from outside the business. Insurers can leverage these efforts to answer key questions that will influence the future state of data-related systems and processes. For example, what information is available from systems vendors, reinsurance partners and third-party administrators? What LDTI functionality and processes can vendors provide? How does deferral impact insurers and their third parties differently, and what information gaps does that create? What data gaps need to be filled? What additional controls are needed around new data elements?

5 Scenario plan, scenario plan, scenario plan.

Every accounting change comes with uncertainty. But with a longer implementation period, insurers have a chance to address complexities and challenges and reduce the chance of error and the need for remediation. Consider spending the extra time anticipating and preparing for a variety of possible situations post-adoption. First, identify where the biggest areas of uncertainty exist and develop plans for dealing with a range of different possible outcomes. For example, are there new features or upgrades planned for actuarial, accounting and financial reporting technologies? Are there impending retirements, terminations or departures that will change the department's staffing outlook? Is the business considering a merger or acquisition that would disrupt current processes? Perhaps most importantly, is the regulatory environment in flux? During scenario planning, pay close attention to possible changes to the LDTI standard or clarifications from the FASB or industry groups—particularly for areas of the standard where guidance and industry consensus is emerging.

6 Prepare for downstream impacts.

LDTI will have indirect effects on various parts of an insurance organization. Focusing on downstream impacts can help insurers avoid potential financial or regulatory problems down the road and better position them to compete in the future. For example, the changes to accounting for market risk benefits could alter insurers' hedging strategy. Changes in profitability metrics could impact product pricing decisions. And, insurers may need to review and update compensation structures that are linked to pricing and key performance indicators.

7 Get ahead of audit issues.

The deferral allows insurers to lessen the chance of unexpected negative audit results as they adopt the new standard by resolving issues before transition. Seek out recommendations from internal and external auditors about key accounting policy and actuarial methodology decisions. Also engage the auditor in identifying additional processes and controls that may be necessary for compliance with SOX and other regulations, now and in the future. And finally, revise the implementation roadmap based on auditor feedback.

8 Better align and leverage talent.

With additional transition time, insurers can optimize the use of human resources, allowing implementation teams to work smarter, not harder. Review the talent pool—both internal and external—to verify the right knowledge, experience and capabilities are available to support the implementation effort. Develop a strategy to effectively and efficiently fill skill gaps, whether through hiring or training. And, recognizing the extended timeline could create "implementation fatigue," consider ways to keep the transition team motivated and energized, such as staff rotations.

9 Enhance stakeholder communication.

Once the transition is complete, complying with LDTI will alter insurers' financial results. Use the deferral as an opportunity to help internal and external stakeholders—from senior corporate leaders and the board, to investors and the public—understand and interpret financial performance (i.e., how are you going to "tell your story?"). In addition, determine whether new or revised performance metrics are required for accurate, transparent and compliant reporting and disclosure.

How KPMG can help

KPMG helps insurance companies impacted by LDTI to design and adopt revised policies and procedures considering the new accounting requirements—and generate long-term value from the implementation effort. Led by a cross-functional team of technical accounting, actuarial, data and insurance sector specialists, our goal is to guide companies through a seamless and cost-effective transition that not only boosts confidence in compliance, but sets the stage for broad finance transformation.

With the knowledge, insight and perspective that comes only from deep experience, our key capabilities support insurers through the entire implementation journey, including:

- Performing gap assessments
- Guiding solution design, configuration and selection
- Testing new and revised processes and systems
- Delivering on-call technical advice
- Advising on data handling and management
- Advising on changes in finance and accounting roles
- Support change management efforts

Comprehensive accounting change framework

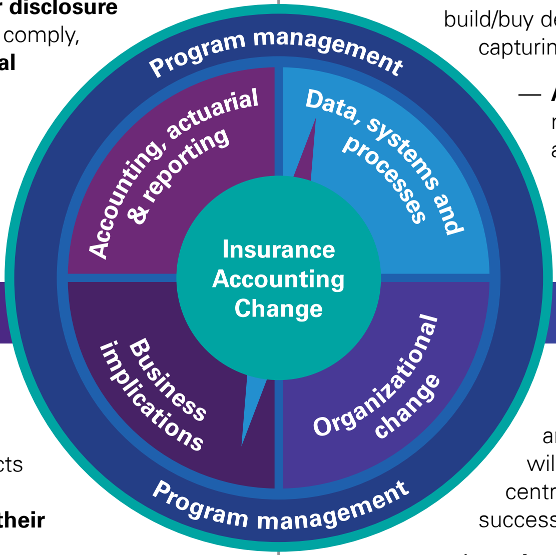
KPMG's robust U.S. GAAP conversion methodology has been tailored in response to the unique challenges posed to companies implementing ASU 2018-12. Our insurance accounting change compass ensures we consider the holistic impact of each key decision.

Accounting, modelling & reporting

- ASU 2018-12 contains a number of **accounting and actuarial policy** choices and key judgements within interpretation, application and operationalization. These will impact **external reporting, management reporting/planning, and actuarial.**
- Making the "right" choice means clearly defining priorities, testing the financial and operational implications, and revisiting those choices and judgments in light of findings.
- The standard introduces more **granular disclosure requirements.** Companies will need to comply, but more importantly reconsider **internal and externalreporting and analysis** as well as impact on internal and external KPIs.

Data, systems & processes

- Additional data points and increased granularity are required to comply with ASU 2018-12 at transition and going forward. **Sourcing complete and accurate disaggregated data** in a timely manner will prove a unique challenge for companies implementing ASU2018-12.
- As opportunities to adopt more consistent systems and processes arise, companies should consider opportunities to **maximize value and minimize IT spend** (e.g., centralizing build/buy decisions and implementation efforts for capturing actual experience in actuarial systems).
- **Automation of certain manual processes** may be required due to resource constraints and increased risk of error. The priorities will vary, but increased consistency creates opportunities for alignment.



Business implications

- ASU 2018-12 will create **accounting mismatches** between investments and reserves. In response, companies will be looking to revisit existing contracts and their pricing strategies. Companies will need tounderstand the **impact on their products and businesses.**
- The **use of non-GAAP measures** for reporting results hasreceived significant attention by the SEC. While use of non-GAAPmeasures is permitted, the **application and strategic use will need to be reevaluated.**
- Additional implications are expected with **internal controls** and potential adjustment to **investment/hedging** strategies.
- Where internal remuneration is impacted by U.S. GAAP results, **a reevaluation of policies is also in order.**

Organizational change

- An appropriate **program structure** will drive decision making, improve efficiency and help ensure accountability. Companies will need to **strike the right balance** between centralized and de-centralized structure to enable successful programs at subsidiaries.
- A **roadmap** will help stakeholders understand the scope of the project, timing of activities, and provide a basis for detailed action plans. Companies need to incorporate industry lobbying efforts and accelerate their programs to strategically address client needs.
- Appropriate **governance** (e.g., status update meetings, steering committee involvement and project risk management) are vital to the success of a large-scale accounting change implementation.

Insurance Accounting Change Leaders

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Laura Gray is the national leader of KPMG's Actuarial practice and a principal of the firm. With more than 25 years of insurance industry consulting experience, she advises life insurance companies on financial reporting, regulatory compliance and modeling issues, including assessing the impact of LDTI. Laura co-sponsors the KPMG Insurance Accounting Change solution team, where she leads the development and delivery of client services to assess and implement accounting change.

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Michael Lammons is a partner in KPMG's Accounting Advisory practice. Focusing on the global insurance industry, he has more than 25 years of experience helping companies apply various accounting standards, including IFRS, US GAAP, US STAT and GASB principles. Michael provides a broad range of services to a variety of clients, covering accounting change and accounting transactions such as M&A, IPO and LBO transactions. As a co-leader of Insurance Accounting Change at KPMG, he leads the development of tools which serve as accelerators in the delivery of client services across all phases of implementation.

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