



**Integrating Implementation
for IFRS 17 and LDTI**

International Financial Reporting Standard (IFRS) 17, issued by the International Accounting Standards Board (IASB) in May 2017, introduces for the first time a single insurance accounting model for all types of insurance contracts under IFRS. The key objective is to make insurance accounting transparent and consistent across the globe and align insurance accounting with IFRS accounting of other industries to improve comparability. As of now, over 120 countries have adopted or permitted IFRS 17.

U.S. is one of the few countries that have decided not to adopt IFRS 17. In fact, in August 2018, the U.S. Financial Accounting Standards Board (FASB) issued its own Accounting Standards Update (ASU) 2018-12, also known as Targeted Improvements for Long-Duration Contracts (LDTI). LDTI amends the existing accounting requirements under US Generally Accepted Accounting Principles (USGAAP) for certain long-duration insurance contracts such as life insurance, disability income, long-term care, and annuities. It represents the most significant change in the past four decades to the U.S. insurance accounting framework.

Both IFRS 17 and LDTI are expected to be effective starting January 2022¹. The U.S. is the largest insurance market in the world where almost all large global insurers have a footprint. U.S. multi-national insurance companies have extensive operations in countries where local IFRS reporting is mandated and USGAAP reporting is not acceptable for compliance with local laws. Against this backdrop, having a different U.S. insurance accounting standard creates some complications and challenges. Specifically, for those public companies headquartered in the U.S., their international operations need to file under USGAAP for consolidated reporting

thus need to implement LDTI, while having to implement IFRS 17 for local country reporting. For those public companies operating in the U.S. but headquartered in a country that adopts IFRS 17, the U.S. subsidiary will need to implement LDTI if it's a SEC registrant, while supporting its parent for IFRS 17 reporting.

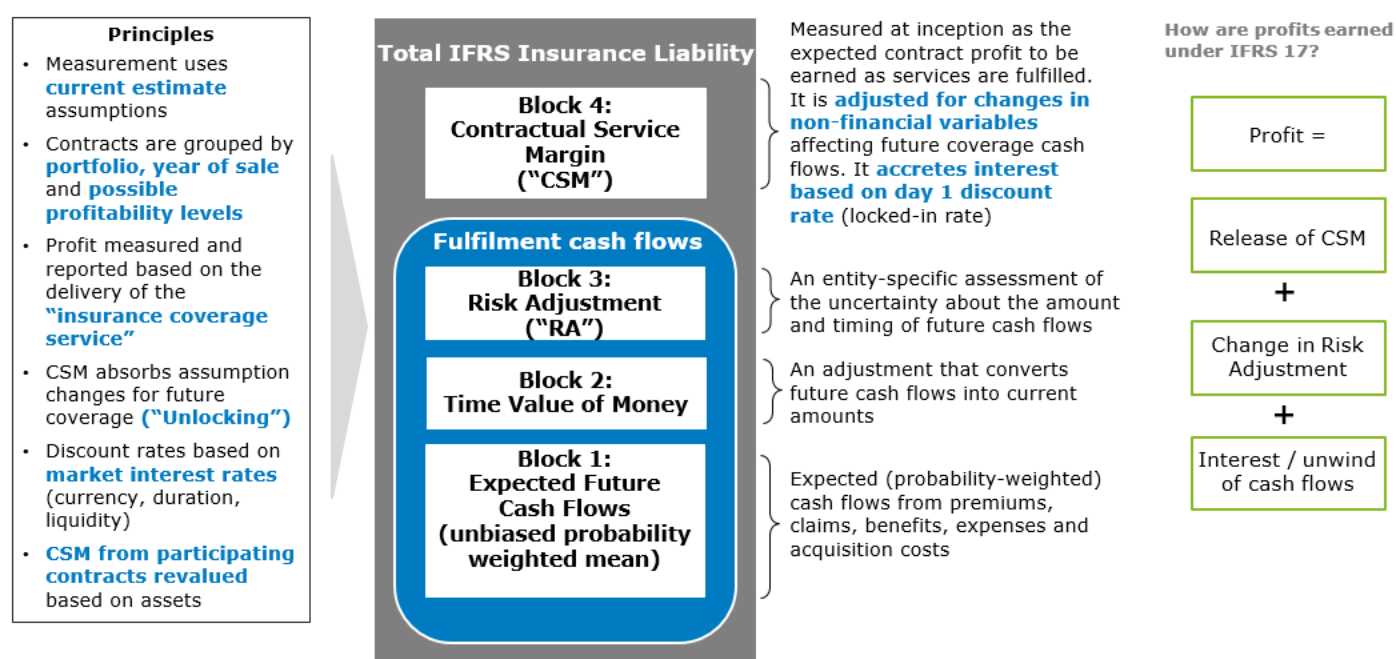
In addition, there are other changing regulations globally that compound the challenges for global insurers, such as changes in local capital regulations (Hong Kong RBC, Korea ICS etc.), U.S. FASB's current expected credit loss (CECL) model, and U.S. statutory modifications toward principal-based reserving. These changes demand substantial implementation efforts that can squeeze an organization's limited finance, IT and actuarial resources. It also creates opportunities to leverage intersections of these regulations to maximize synergies and resources for implementation time and cost savings. In this new issue of Deloitte Insurance Accounting Insights, we will focus on synergies that can be gained through the integrated implementation of IFRS 17 and LDTI for global insurers affected by both standards.

Comparing IFRS 17 and LDTI

IFRS 17

IFRS 17 is applicable to insurance and reinsurance contracts issued by a company, reinsurance contracts that a company holds ("ceded reinsurance"), and investment contracts with discretionary participation features ("DPF") that it issues, provided that the company also issues insurance contracts.

Figure 1: IFRS 17–Summary of General Measurement Model (often referred to as the Building Block Approach)



1. Both the LDTI and IFRS 17 Regulation are currently in the process of a public due process regarding their effective dates. This publication is written with the anticipation that both proposed dates of 2022 will be confirmed at the end of the consultation process.

There are variations and simplifications for certain insurance products but the General Measurement Model is essentially the one model that is introduced under IFRS 17. This model utilizes current assumptions, and includes a risk adjustment for non-financial risks and a contractual service margin that releases over time into profits. It requires identification of contract groups at a very granular level for measurement purpose, at which profits and losses are recognized. There are also significant changes on the presentation and disclosures of financial information. On 26 June 2019, IASB published an Exposure Draft, 'Amendments to IFRS 17' to address concerns and implementation challenges. The Exposure Draft's publication follows an assessment of 25 concerns, identified during the IASB's meeting in October 2018, of areas of IFRS 17 that global stakeholders recommended to the IASB for potential improvement. Following its assessment, the IASB has proposed a number of targeted amendments, including a one-year deferral of the IFRS 17 effective date to 1 January 2022. Comments were due by 25 September 2019.²

Our analysis shows that while US GAAP is moving closer to a current value framework, for long-duration contracts, there are still fundamental differences in the framework between IFRS 17 and LDTI.

LDTI






The goal of LDTI (or ASU 2018-12) is to improve, simplify, and enhance the financial reporting of long-duration contracts, providing users with more useful information about the amount, timing and uncertainty of cash flows. Figure 2 provides an overview of the changes.

LDTI introduces significant changes on the valuation of long-duration contracts, including the use of current cash flow assumptions and discount rates, a new retrospective unlocking approach for liability for future policy benefits, simplification of the DAC model, and introduction of a new concept called market risk benefit that's subject to fair value measurement. The end result of these technical impacts is a significant increase in financial statement disclosures. New disclosures covering significant detail on liability roll-forwards, separate account, market risk benefit attribution, and DAC roll-forwards will be required under LDTI.

Comparison of Accounting Requirements

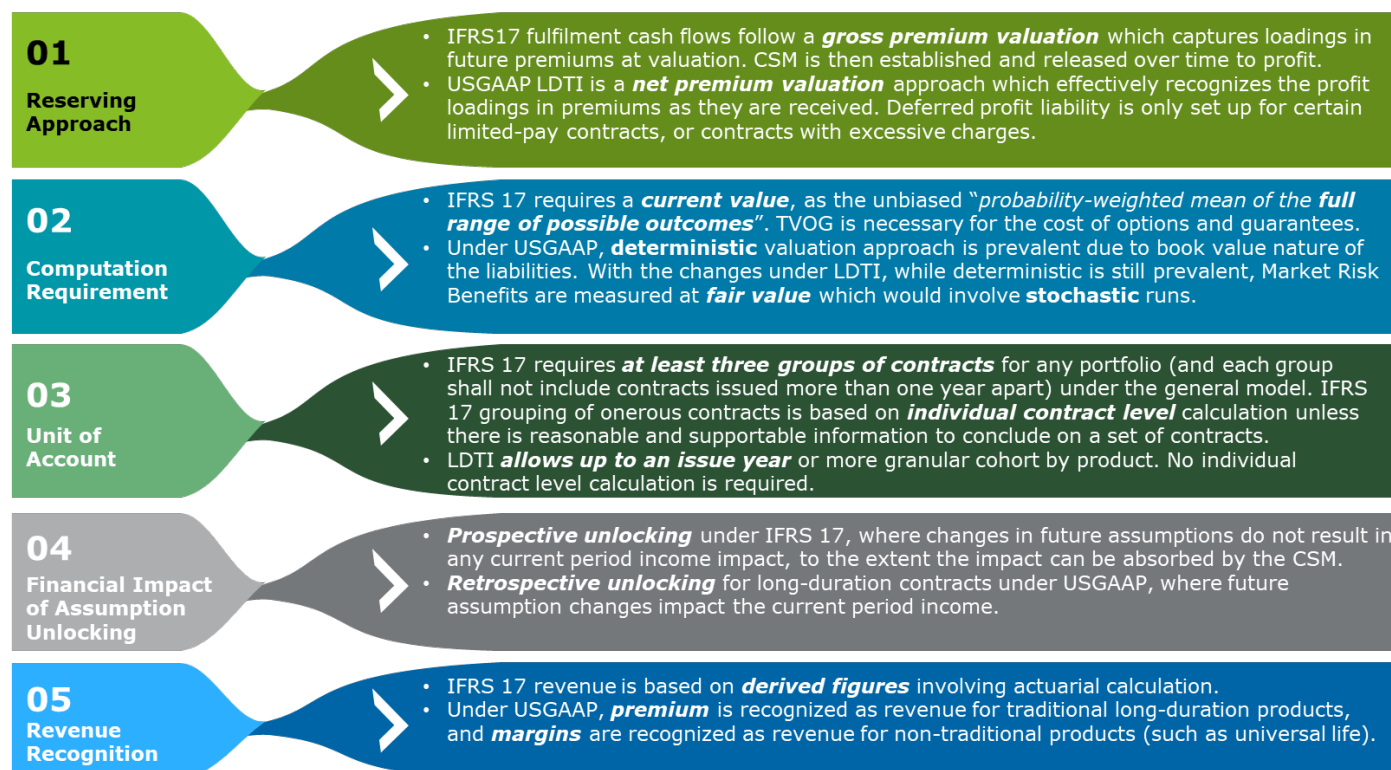
In order to assess the operational overlap in implementing the two standards, Deloitte compared conceptual frameworks and key technical areas of IFRS 17 and LDTI. Our analysis shows that while US GAAP is moving closer to a current value framework, for long-duration contracts, there are still fundamental differences in the framework between IFRS 17 and LDTI.

Figure 2: LDTI—Summary of Targeted Improvements and The Impact

 Cash flow assumptions	 Discount rate	 Retrospective unlocking	 Market risk benefits	 DAC
<p>Cash flow assumptions used to measure the liability for future policy benefits should be updated to current best estimates and recognized in net income.</p> <p>Assumptions need to be reviewed and updated if appropriate on an annual basis, at the same time every year, or more frequently if evidence suggests that previous assumptions should be revised.</p> <p>Related claim expenses include termination and settlement costs and exclude acquisition costs and non-claim related costs.</p>	<p>An insurer should update the discount rate assumptions that it uses to measure the liability for future policy benefits at each reporting date and recognize any effects of the discount rate change immediately in other comprehensive income.</p> <p>The target discount rate should be based on an "upper medium grade (low credit risk) fixed income instrument yield".</p> <p>This essentially means an A-rated corporate bond yield in the US. For other countries it may mean a government or swap rate.</p>	<p>When non-discount rate assumptions are updated, a revised net premium ratio (NPR) will be calculated using actual historical experience, the updated future period cash flow assumption and the discount rate applied at inception.</p> <p>The revised net premium ratio is applied from issue to determine the revised liability as of the B/S date. The difference is reflected in current period operating income.</p> <p>For limited payment contracts the DPL is retrospectively unlocked to a similar effect as unlocking the NPR.</p>	<p>FASB believes that features that meet the definition of "market risk benefits" should be separately measured at fair value.</p> <p>A market risk benefit would be defined as <i>"A contract or contract feature that both provides protection to the contract holder from capital market risk and exposes the insurance entity to other-than-nominal capital market risk."</i></p>	<p>While the definition of expenses eligible for deferral remains unchanged, the FASB has simplified the amortization pattern. DAC is now amortized in proportion to the remaining life of the contract (e.g. policies in force).</p> <p>Additionally, DAC no longer accrues interest.</p>

2. Deloitte responded to the IASB's proposed amendments in a comment letter that can be found here: <https://www.iasplus.com/en/publications/global/comment-letters/2019/ifrs-17>

Figure 3: Key Differences between IFRS 17 and LDTI



In addition to the key methodology and conceptual differences noted above, for requirements surrounding technical topics such as discounting, disclosures, and liability components (IFRS 17 building blocks versus LDTI future policy benefit liability, market risk benefit, and deferred profit liability), there are also various technical differences between the two standards. Due to the many conceptual and technical differences, there is no easy way to identify the deltas or any shortcuts to derive results for one standard based on those for the other. While it may seem necessary to carry out two separate and parallel implementation efforts, we believe there are a number of operational synergies in an integrated implementation journey for the two standards.

Leveraging Operational Synergies

The new IASB and FASB pronouncements will have a pervasive impact on global insurers' operating model. Because both FASB and IASB approaches address similar considerations, companies that need to dual-adopt are finding opportunities for synergies as they refine their approach to implementation. They will be able to align policy decisions while simultaneously adopting both standards without needing to worry about two separate full implementation plans.

We believe there are a number of operational synergies in an integrated implementation journey for the two standards.

For several areas—especially as it relates to process design, modeling system/technologies, data availability and storage capabilities, and reporting solutions—the work companies do to prepare for IFRS 17 compliance may be able to be leveraged for LDTI to enhance efficiencies, increase cost savings, reduce resource requirements and, limit the amount of reworks and time needed to reconcile the results of the two standards.



Processes and System Design

Given the accounting changes prescribed by these standards, insurers may seek to leverage similar processes across bases. For example, they may leverage a centralized method and approach to deriving discount rates for LDTI and IFRS 17 discounted cash flows. In such scenarios, although the standards may apply different rates and apply the rates in different projection tools, converging the process to deriving these rates will facilitate a more integrated environment and eliminate the need for parallel business processes and controls. Additional process changes that may be made consistently across standards may include:

- Certain actuarial software vendors offer projection or valuation models for these standards that, while separate modules, offer solutions that can operate under a single control and technology environment.
- System logic and account mapping changes may be updated in conjunction across standards to support technical reporting requirements. Several finance software vendors have specialized calculation solutions for IFRS 17 and also for LDTI to some extent.
- To the extent that a single vendor solution is used in the valuation of liabilities for LDTI and IFRS 17, the related process flow – from data origination in administrative systems through posting into the general ledger – can leverage similar interfaces and handoffs to ensure consistent transformation routines.
- Consolidation of data repository and reporting solutions can enable consistent back-end storage, reporting, and analysis.

In these instances, the processes, controls, and target operating models that reflect changes to the reserving, finance, and reporting processes can be designed to govern across standards and bases of accounting.



Actuarial Systems and Modeling

Specific modeling and valuation applications may be needed to support updated estimations, risk adjustments, and discount rates associated with these standards. While likely to require separate modeling modules to execute the disparate reserving methodologies, the best estimates cash flow generation engine may remain consistent for both standards. LDTI and IFRS 17 may require insurance-specific vendor decisions and software integration for compliance. As a result, modeling alternatives should be contemplated in tandem so that multiple reserving platforms or procurement of multiple modules are not required to support the standards.



Data Quality and Integration

Data will play a central role in the implementation of both standards. These regulatory changes each require calculations to consider additional data by requiring insurers to unlock liabilities. In addition to the frequency at which these standards require updates/unlocks to their calculations, insurers will face greater data needs to execute these calculations:

- LDTI liability calculations may require significantly larger data volume and granularity of data as the standard states that cohorts cannot “*group contracts from . . . different issue years but [must] group contracts into quarterly or annual groups.*” This may significantly increase the number of cohorts—and corresponding cohort-level data—from current US GAAP. Disclosures will also significantly increase the volume of data through the need to produce granular disaggregated roll-forwards across insurance balances.
- IFRS 17 will require significantly more data due to the need to measure and report insurance liabilities under the variants of the building block approach, increased use of market data compared to prior IFRS requirements, the requirement to segment portfolios based on annual profitability groups, and the requirement for a new method of presenting insurance revenue. IFRS 17 disclosures will also require more extensive disclosures than are currently required.

Additionally, because LDTI and IFRS 17 requirements are adopted retrospectively and require an intensive review of both historical loss data, current conditions, and forecast/projection results, additional IT resources may be needed to support the implementation of the standards. New data extracts, processes, reconciliations, and controls will be required as an input to future state reserving processes. Back-end data storage and reporting to the ledger will need to be updated, scaled, and ideally automated. As a result, these new requirements will significantly impact the need to extract, manage, and store data. By considering the needs collectively, insurers may favour common technology solutions such as data warehouses or unstructured databases with the capabilities to address the new additional data needs.



Financial Reporting and Disclosures

LDTI and IFRS 17 require insurers to expand on existing disclosure requirements. Under LDTI, future required disclosures include disaggregated tabular roll-forwards, reconciliations to core financial statements, and other statistical information across insurance balances on a quarterly and annual basis. Similarly, IFRS 17 requires new detailed roll-forward disclosure tables to be published, at least at an operating segment level, and a reconciliation of the balance sheet items and movements to the respective financial statements.

To comply with these requirements, companies' reporting and governance frameworks may need to be redefined or new tools may need to be implemented to facilitate an efficient reporting process. Defining a new architecture for the data repository, sub-ledger, and general ledger should be at the center of insurers' reporting strategy as strong solutions will facilitate a smooth production run and minimize the operational risk of generating these additional disclosures.

- New required roll-forward disclosures will increase the amount of analysis and the number of model runs
- Analyzing these disclosures and determining a management reporting framework will allow actuaries to design, automate, and minimize the number of runs needed to perform these roll-forwards and analysis.
 - LDTI prescribes that the assumption unlocking should occur at the beginning of the period
 - Under IFRS 17, the order of operations for roll-forward are not prescribed outside of CSM amortization.
 - Companies should consider whether assumption unlocking for IFRS 17 also should occur as of the beginning of the period in order to minimize the number of runs required.
- Similar synergies would exist for reporting actual experience and ensuring a consistent order of operations will be vital to minimizing the number of required valuation runs.

US GAAP-basis and IFRS-basis impacts to determine whether additional reinsurance is desired to more effectively manage their risk.

- **Product design and pricing:** On a US GAAP basis, the de-linking of the insurance discount rate from the asset portfolio when measuring earnings for post-adoption business and the prospective LDTI measurement models may cause insurers to re-evaluate their pricing on current and future products. On an IFRS-basis, insurers will similarly face a new measurement model and may consider shifts in their portfolio pricing and risk appetite due to the IFRS 17 requirement to segment based on profitability at initial recognition date.
- **Treasury/capital management:** Under US GAAP and IFRS accounting, insurers may experience significant shifts in volatility of both earnings and equity that could impact leverage targets, capital flexibility, required capital, hedging, and cost of capital. Under LDTI, macroeconomic assumptions that were locked in the previous USGAAP accounting for certain business will be periodically unlocked under LDTI. IFRS 17 also introduces a greater use of market data to update assumptions used in determining the contractual service margin of the related contracts and could therefore impact company-specific capital management.

Given the scope of these changes, a broad plan that effectively leverages the interdependencies between these standards can help insurers manage the changes both at adoption date and prospectively. Understanding the comparison and synergies between the two standards can also help insurers better explain and rationalize the differences in IFRS 17 vs. LDTI earnings. To facilitate a more effective implementation, insurers should review their respective impact assessments to identify areas of overlap, and leverage those in pursuit of an integrated, end-to-end design to implement multi-purpose processes and controls that converge across standards.



Policy Development

Accounting/Actuarial policies will need to be established/modified. Under both standards, assumptions are required to stay current. Data sourcing for discount rates, the technique to develop a yield curve and a unit of account are common topics for which accounting policies can be designed in an integrated fashion.

Assessing functional impacts

Each of the standards may individually drive changes in the way insurers manage their business, as many anticipate significant shifts in the timing and volatility in which earnings will emerge. Certain functions sit at the intersection of these impacts. To effectively manage these changes, functions may need to re-evaluate the tools and analytics currently applied in today's decision-making processes. While these changes will be felt across the organization, the following represent those functions that may be most impacted by the intersection of the changes:

- **Investment management:** Insurers with a more US GAAP-centric investment strategy may consider adjustments to their asset portfolios and derivative/hedging strategies given the de-linking of the asset portfolio from the liability discount rate under LDTI. However, even those with an IFRS-focused strategy may seek to refine their investment strategy in consideration of volatility shifts across accounting bases.
- **Risk management:** Many insurers heavily leverage reinsurance as a means of managing risk and/or earnings patterns. Under these standards, insurers may therefore seek to evaluate their

Moving forward

Smart compliance seeks the optimal trade-off between achieving minimum compliance and a desired level of sustainable future efficiencies. Considering the timeline for implementation, the breadth of the prescribed changes, and companies' time and resource constraints, some insurers plan for short-term solutions that will enable required reporting. However, others are looking to broaden and modernize their minimum compliance efforts to develop an effective future-state operating model. While achieving full modernization prior to the new standards' effective dates is likely to be unfeasible for many of these insurers, in particular those global insurers subject to both IFRS 17 and LDTI, those working to kick-start smart compliance will evaluate their current framework for capability gaps and then balance the cost and timeline implications to realize maximum value from their implementation efforts. IFRS 17 and LDTI address similar considerations, this basic fact gives a logical basis for companies that need to dual-adopt to actively consider leveraging potential synergies between the two standards in their implementation planning.

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