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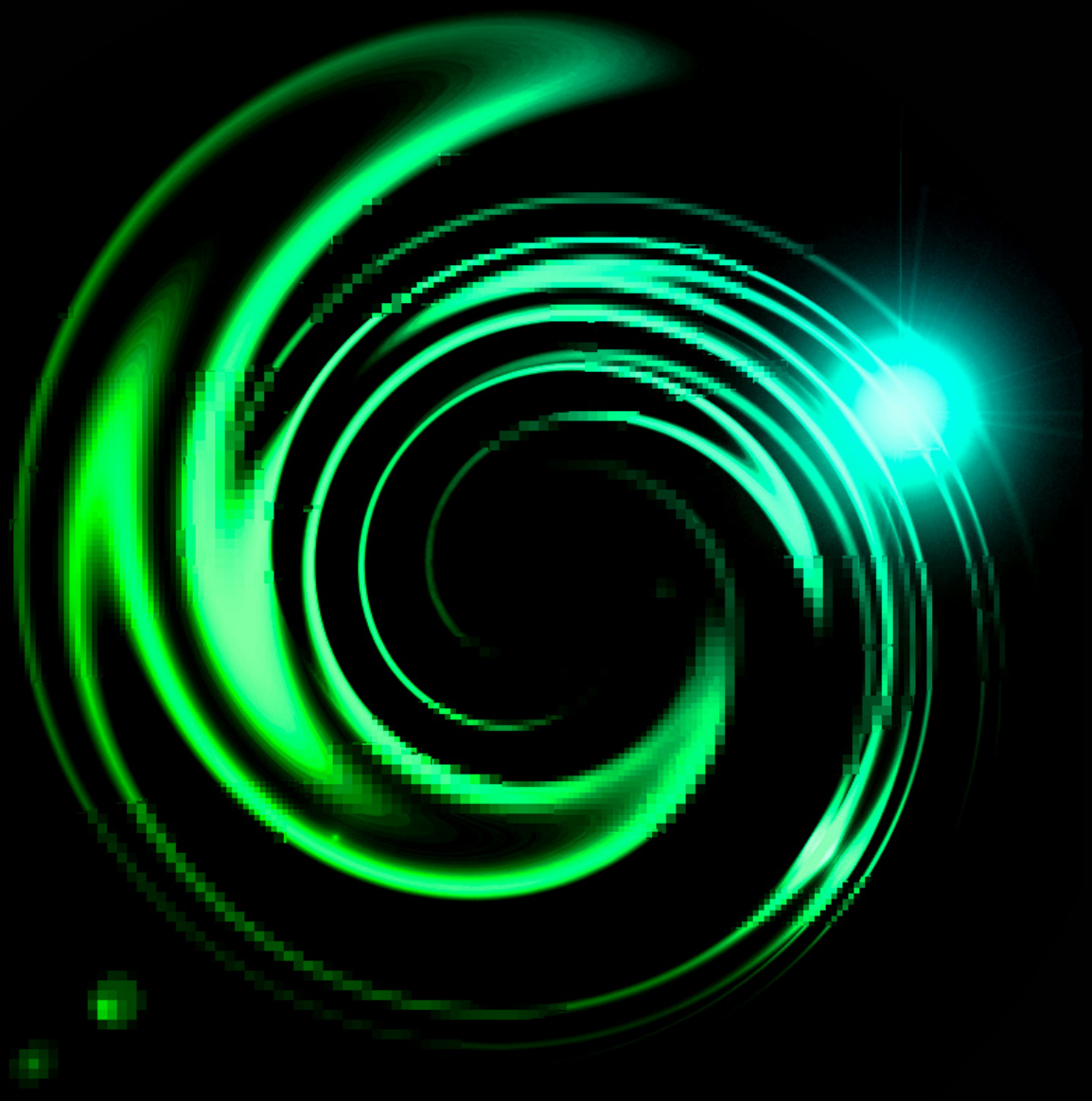

COVID-19 impact on insurers' LDTI implementation journey

The COVID-19 pandemic and the subsequent volatility in market conditions are having a profound impact on the global economy. Countries around the world have been forced to take drastic actions to slow the outbreak—requiring businesses to implement virtual working strategies and take other unprecedented measures to weather the storm. For an industry already under pressure from low interest rates, stiff competition in the marketplace, changing distribution models, and technological disruptors, the uncertainty that exists in these unprecedented times creates both short and long-term obstacles to ongoing initiatives, and transformations must adapt to the changing environment.

Perhaps the most significant of the initiatives that insurers must continue to drive forward in the face of these headwinds is the implementation of the FASB's ASU 2018-12, Targeted Improvements for Long-Duration Contracts (LDTI). For insurers to adapt their implementation projects, decision-makers must evaluate and understand the areas that will be most affected by the pandemic.

COVID-19 implementation challenges

Virtual work environment

During the COVID-19 pandemic, companies have been forced to perform most, if not all, of their operations virtually due to social distancing guidelines. Managing remotely adds a layer of complexity in terms of system access and processing time. The swift transition to a remote workforce has increased collaboration between information technology (IT), finance, and actuarial departments to meet business needs and continued operations. Utilizing this increased collaboration will serve as a long-term benefit to LDTI. However, the reality is that some insurers may face challenges in continuing to execute business-as-usual (BAU) activities under the remote environment while maintaining implementation program momentum. This results in resources dedicated to implementation efforts being redeployed into BAU roles to execute key actuarial, technology, and finance activities that support the financial close process.

As insurers finalize their first-quarter close, it will be critical to assess the impacts that the virtual work environment has had on the implementation. Lessons learned may change the way organizations are implementing the new standard, and insurers may feel the need to scale up resource efforts if key milestones are in jeopardy. Roadmaps should also be reviewed to assess opportunities to increase flexibility and agility to adapt to the uncertain environment. Such flexibility will prove essential if the environment persists longer than expected or COVID-19 resurfaces and forces companies to resume remote activity.

Additionally, because of the virtual work environment, the IT function will play a more prominent role in project implementation. Organizations should leverage the IT function to ensure system capability and network infrastructure are intact at all phases throughout the implementation.

The project management function also becomes increasingly important to manage the information that is cross-functionally shared in a remote work environment. Increased use of meetings, dashboards, and distributions may help program leaders quickly identify and address challenges that arise in a virtual environment. Additionally, companies may seek to use a wide range of collaboration tools, such as file-sharing, videoconferencing, and communication platforms, to maintain the appropriate levels of coordination necessary to support an effective implementation.

Looking over a longer time horizon, the shift to a virtual workforce will present an opportunity for companies to accelerate future-of-work initiatives. Companies are gaining real-time experience related to flexible staffing models and remote capabilities. The COVID-19 crisis has provided evidence that increased flexibility can work.

Financial impacts

The current economic environment may have a profound impact on insurers' profitability. The low interest-rate environment, increased equity market volatility, and reduced sales—combined with unpredictable policyholder behavior—will challenge the ability to predict and optimize investment opportunities. The volatility in actuarial balances will require increased attention and analysis due to increased strain on capital positions.

This may force key decision-makers to consider cutting costs across organizational projects and initiatives. While such cuts to LDTI implementations may result in short-term savings, they may come at a greater long-term cost. Cost-cutting measures across the organization may force organizations to move closer toward the concept of a "minimum or manual compliance" implementation, rather than a focus on more targeted modernization that we have observed happening in the marketplace. Such a shift may lead to more "day two" spending on optimization initiatives to improve temporary solutions and processes.

Analysis of results

The ultimate effects of COVID-19's impact on the global economy remain uncertain. However, the economic environment realized during the first few months of 2020 represents an unprecedented outcome that may have a pointed impact on how a company's results manifest post-transition. These shifts are particularly notable, given that LDTI is generally expected to cause greater equity and earnings volatility than current Generally Accepted Accounting Principles (GAAP). For companies that have already begun to estimate LDTI impacts, macroeconomic factors could significantly affect previously developed estimates. Insurers may therefore look to refresh these estimates to better reflect the reality of the current environment.

The economic environment may also influence the timing and nature of insurers' strategy for communicating to external audiences. It will likely influence how insurers describe their business within disclosures once financial statements are issued. Additionally, as insurers look to communicate transition and ongoing impacts on rating agencies, analysts, and investors, it will be critical to understand forecasted earnings and equity impacts across a range of economic scenarios and sensitivities. That analysis may need to be extended to anticipate a wider range of factors and outcomes given the environment that emerged.

Insurers' assessments of LDTI impacts on asset and liability management (ALM), enterprise risk management (ERM), and hedging strategies may need to be similarly expanded given the emergence of the likely unforeseen economic environment. Insurers are assessing the effectiveness of their hedge programs and considering their cash flow expectations over the next year as a result of COVID-19. Given the LDTI pivot date for public companies was January 1, 2020, companies will need to think through how comparative financials will look post-adoption.

Vendor and third-party reliance

Third-party vendors and service providers have also had to adapt to the unique environment caused by COVID-19. Many insurer implementations are heavily dependent on technology vendors to produce LDTI-compliant environments that support the calculation, storage, and reporting of financial results. Vendors should be engaged to determine the probability and extent of COVID-19–related delays of key delivery milestones. Contingency plans should also be developed to address any identified risks of vendor and third-party delays. If such key milestones are missed, insurers may feel a cascading effect that causes corresponding delays in implementation, testing, and restatement-related activities.

Additionally, many implementations place heavy reliance on third-party administrators and reinsurance partners to provide key required data elements and reserve information. These counterparties should be similarly engaged to better understand the impact of COVID-19 on the capabilities of organizations in producing timely and granular data.

Potential deferral of LDTI

There have been conversations in the marketplace about whether or not insurers may need additional time to implement LDTI given the financial and operational hurdles facing the industry under COVID-19. It remains unclear whether a deferral or other changes to LDTI will happen, but any modification may be the most significant impact COVID-19 may have on an LDTI project.

The potential for a deferral may also affect insurers' LDTI funding decisions. Because implementations would occur over a longer timescale in the event of a deferral, insurers may anticipate increases in certain overhead costs to effectively manage the program. Program leaders may therefore seek potential savings to offset these increases to mitigate bottom-line impacts of the implementation.

Our perspective on the impacts of an LDTI deferral

All affected insurers should reevaluate their planned implementation activities and consider how their timelines may have been impacted by COVID-19 and how roadmaps could be modified. While we are not taking a position for or against a change to the LDTI implementation date, we have developed a view of how insurers might use the additional time, if it were granted:

- **Progress to date:** Where do insurers currently stand against their roadmaps designed for a January 1, 2022, effective date (for most public companies)?
- **Forward look:** Assess the impacts to individual implementation activities—this will vary based on where insurers stand with respect to their broader implementation, and a desire to recast the timeline for larger and complex initiatives (such as reporting automation and close acceleration).

In addition to the foundational impacts that insurers may realize on their end-to-end build and development, integration and user acceptance testing, restatement planning and approach, and stakeholder education, insurers should also consider potential impacts on the following activities:

- Program governance
- Accounting policy and actuarial methodology
- External and management reporting
- IT infrastructure development
- Pricing and assumptions development
- Forecasting
- Treasury
- Asset and liability management
- Enterprise risk management
- SOX, internal audit, and external audit

- **Resource constraints:** Personnel availability and budget should be considered in determining how existing activities could be modified and what activities may be added or removed if a deferral is granted.

The impacts of a deferral on an LDTI implementation will be unique to each insurer. However, the following represent some of the most notable areas where companies are likely to want to reassess key milestone timelines, especially if they were behind on their roadmaps prior to COVID-19:

- **End-to-end build and development:** A key component of insurers' implementation plans is the development and implementation of new or updated valuation models and their integration with data landing zones and, ultimately, the general ledger and disclosures. These system impacts must include LDTI model changes, enhanced granularity needed to support LDTI disclosures, and the additional updates needed for the modified financial statement presentation. Depending on where insurers stand in their system enhancement and model development life cycle, a one-year LDTI deferral may offer additional time for insurers to develop or enhance LDTI-compliant models, including further automation of reporting and analytics—thus improving both the lift and timeline for restating comparative periods (see "Restatement planning and approach," below) and in BAU.
- **Integration and user acceptance testing (UAT):** LDTI compliance will require new or modified data extracts and repositories, actuarial models, finance processes, and IT systems and infrastructure. Given these changes, integration and UAT activities will be a critical element to ensure a cohesive end-to-end process. A one-year LDTI deferral would allow insurers to expand the timing and extent of these critical activities. This would provide a greater opportunity to identify and resolve issues prior to the restatement periods, when actuarial and finance personnel will have less capacity to address challenges that emerge.
- **Restatement planning and approach:** A deferral would affect the periods that insurers are required to restate and disclose externally. As a result, companies should adjust the restatement plan to better align with both the periods requiring restatement and the timeline in which models, technology solutions, and processes are developed and tested. If insurers can complete their key implementation and testing-related activities, a deferral may also provide additional time to produce restated financial results.
- **Stakeholder education:** Stakeholder education is a key element of many insurers' implementation plans. LDTI program leadership should evaluate the activities and timelines to educate stakeholders on the impacts of LDTI, considering both internal stakeholders (i.e., board of directors, audit committees, investor relations, and rating agencies) and external stakeholders. Insurers that had not previously anticipated having the capacity to complete stakeholder education may consider enhancing the education curriculum, given a revised LDTI preparation timeline.

Additionally, existing planned activities may be postponed to better align with the revised deferral go-live date, ensure training materials align with the most up-to-date restatement information, and provide stakeholders training when most applicable.

How insurers should manage COVID-19 impacts

Despite the challenges insurers face in the current environment, implementation progress must nevertheless continue to achieve effective compliance. Given these dynamic changes, organizations should evaluate pressure points in existing implementation plans, consider how to best pursue an agile implementation approach, and be prepared to make best use of the extension in the event the standard's effective date is ultimately deferred. Effective planning across these areas will ensure that programs maintain the momentum needed to deliver a successful implementation in the face of COVID-19.

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