Supplemental Health, DI & LTC Conference

New GAAP Accounting Standards

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Agenda

1 LDTI introduction and overview

2 Considerations and case studies

3 Industry snapshot and Day-2 items

Introduction and Overview

LDTI Overview: Timeline

ASU 2018-12

In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update 2018-12 (“ASU 2018-12”), commonly referred to as targeted improvements for long-duration insurance contracts (“LDTI”)

ASU 2018-12 issued
Aug 15, 2018

Transition
Jan 1, 2021

Effective for public entities
Jan 1, 2023

Effective for non-public entities
Jan 1, 2025

8 quarters of historical comparative financials + 1/1/21 transition financials

LDTI applies to all long-duration life, health, and annuity business with optional restatement for prior reporting periods

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LDTI Overview: Objectives

The goal of the updates is to improve, simplify, and enhance the financial reporting requirements for long-duration contracts

1. Simplify amortization of deferred acquisition costs
2. Improve the timeliness of recognizing changes in the expected liability for traditional and limited pay future policy benefits
3. Simplify and make consistent accounting for certain market-based options or guarantees associated with deposit (or account balance) contracts
4. Improve the effectiveness of required disclosures

LDTI Overview: What's Changing?

LDTI significantly impacts GAAP valuation for long-duration health business (e.g., IDI, supplemental benefits) and long-term care business

Balances	Component	FAS 60	LDTI
Liability for future policy benefits ("LFPB")	Level of calculation	• Policy ("seriatim") level • ALR and DLR calculated independently	• Grouped ("cohort") level • ALR and DLR combined for reserve calculation
	Assumptions and experience	• ALR assumptions set at inception reflecting provisions for adverse deviation ("PADs") and only unlocked if there is a loss recognition event • Net premium ratio locked-in at issue • DLR assumptions reflect best estimates with unlocking	• Assumptions reflect best estimates with unlocking • Net premium ratio ("NPR") unlocked retrospectively • Historical cash flow experience ("actuals") reflected in NPR
	Expenses	All expenses included	Maintenance expenses excluded
	Discount rates	• ALR: reflects book yield plus PAD, set at inception date • DLR: reflects book yield, set at incurral date	• Reflects upper medium grade rates • Rate is locked in at inception date for net income • Unlocking impact flows through other comprehensive income ("OCI")
Deferred acquisition costs ("DAC")	Level of calculation	Seriatim level	Cohort level[1]
	Amortization basis	Premium revenue received; only includes active phase of contract	In-force metric (e.g., policy count); includes both active and disabled phases of contract
	Calculation	• Includes interest accrual • Retrospective • Locked-in ALR assumptions • Projected future deferrals included in amortization factor	• Does not include interest accrual • Prospective • Unlocked assumptions (same as LFPB) • Deferrals capitalized as incurred

1. ASU 2018-12 permits both seriatim and grouped level calculation; however, majority of companies have elected grouped (i.e., cohort) level

Considerations and Case Studies

LDTI Considerations for Health & Long-Term Care Business

Potential for impact

Category		Considerations	Operational	Financial	Real world example and lessons learned
Benefit liability	1	Single unit of account (ALR and DLR)	🔴	🔴	**Example:** An LTC carrier's unexpected termination event decreased DLR significantly, increasing ALR due to the decrease in net premium ratios **Lesson learned:** While movement of "DLR" is largely unchanged under LDTI, ALR movements can be intuitive; companies will need to build intuition and analytics tools to understand movements in an integrated reserve
Benefit liability	2	Long-term accrual balances (IBNR, ICOS, etc.)	🟡	🟡	**Example:** An individual disability insurer struggled to compare actual-to-expected benefits for new cohorts after choosing to include the change in IBNR in historicals **Lesson learned:** The level at which accrual balances are calculated and the manner in which they are allocated to the cohort-level under LDTI should be considered during implementation and analysis
Intangibles	3	Capitalization of deferable costs "as incurred"	🟢	🔴	**Example:** A voluntary benefits carrier experienced significantly slower DAC amortization under LDTI **Lesson learned:** LDTI's exclusion of future deferrable costs from DAC calculations can slow down DAC amortization considerably, resulting in earlier recognition of earnings for business with later ultimate commissions
Intangibles	4	Grouped-level calculation	🟢	🟡	**Example:** An individual disability insurer saw a muted impact on DAC after a large, unexpected lapse event **Lesson learned:** Grouped-level calculation of DAC spreads out the impact of persistency deviation over the life of each cohort, decreasing the volatility compared to FAS 60, in which each individual contract had it's own DAC amount that would be released upon lapse or death

🔴 High impact 🟡 Medium impact 🟢 Low impact

Case Study 1: Reserve Patterns

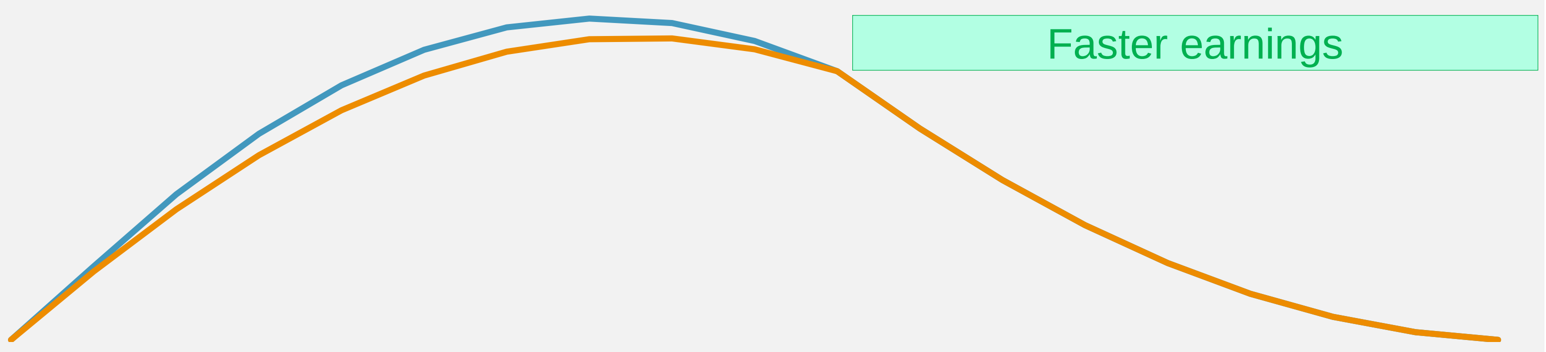
Reserve run-off pattern

Case A: Reserve accrual and run-off for new business

FAS 60: Includes provisions for adverse deviations ("PADs")

LDTI: Valued using best estimate assumptions

Conclusion: Removal of PADs leads to lower reserve accretion / quicker reserve run-off accelerating earnings emergence

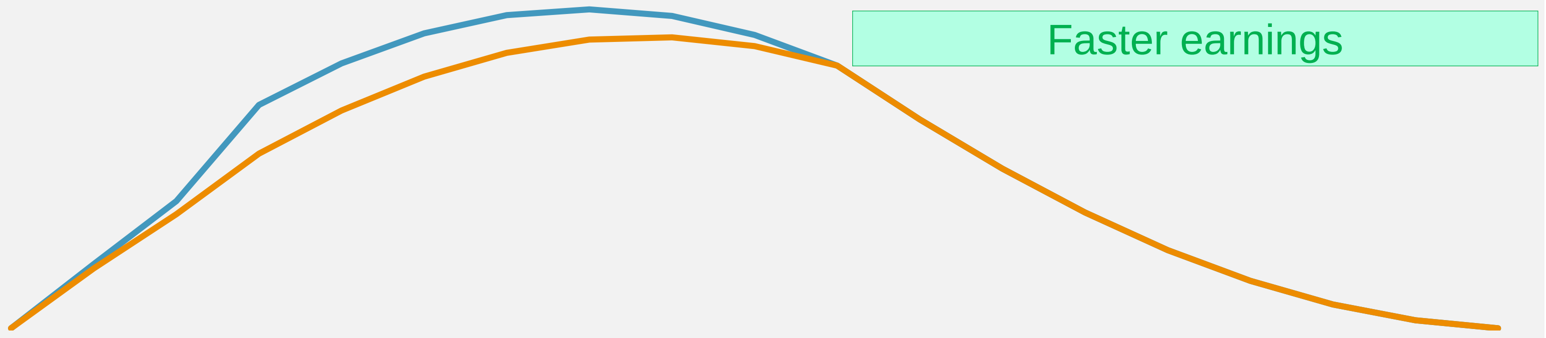


Case B: Termination assumption increase

FAS 60: Disabled life reserve "snaps" to reflect updated best estimate assumption

LDTI: Net premium ratio is unlocked dampening reserve volatility

Conclusion: Net premium ratio dampens the impact of the assumption update resulting in lower reserve accretion and acceleration of earnings

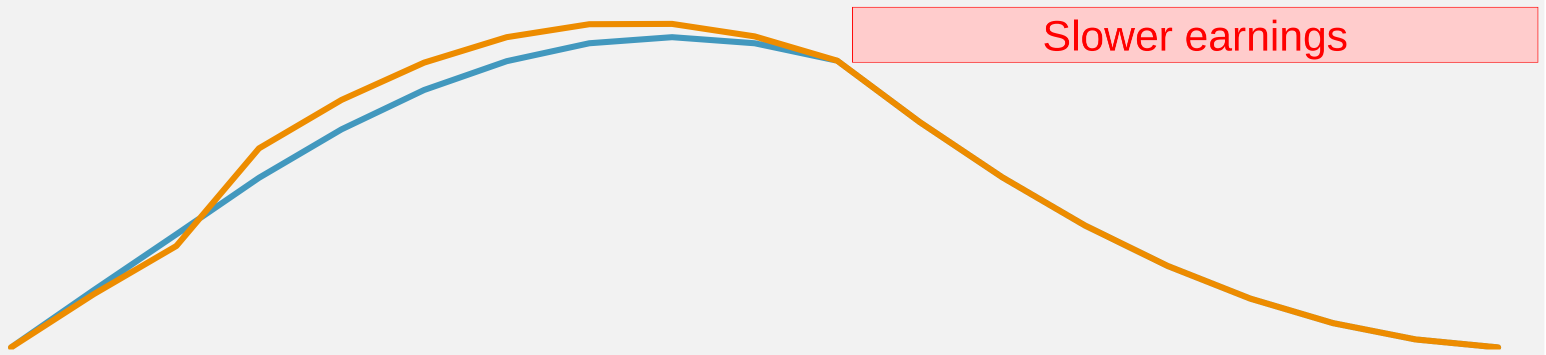


Case C: Incidence assumption increase

FAS 60: Active life reserve is locked in unless loss recognition event is triggered

LDTI: Reserve is unlocked to reflect revised best estimate assumption

Conclusion: Reserve unlocks under LDTI, and the increased incidence assumption leads to additional reserve accrual resulting in earnings deceleration



Case Study 2: Amortization of Intangibles

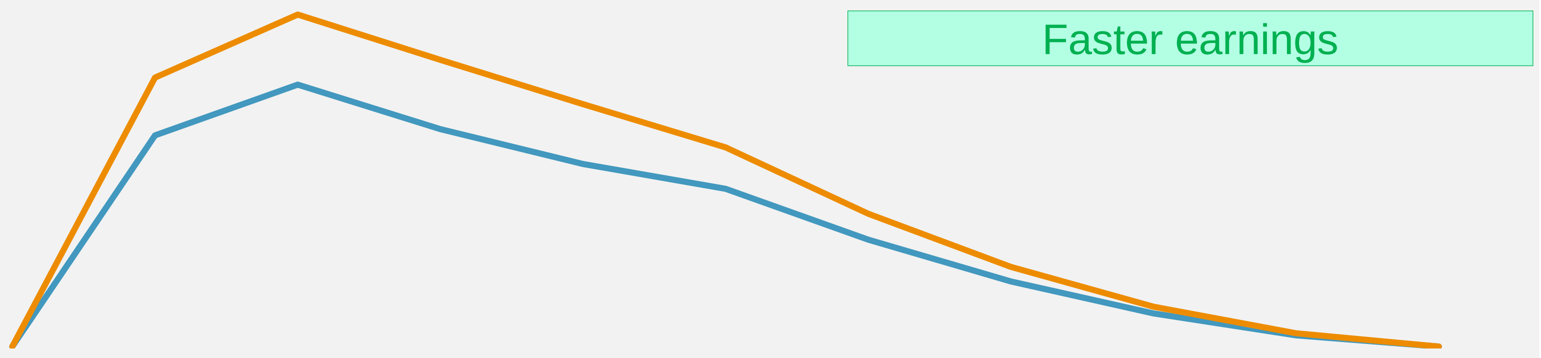
DAC / VOBA run-off pattern

Case A: DAC for new business

FAS 60: Amortization factor includes projected future deferable costs

LDTI: Amortization factor only includes deferable costs incurred to date

Conclusion: Exclusion of projected deferable costs from the amortization factor under LDTI slows down amortization for new business, particularly when commission schedules take multiple years to reach an ultimate rate

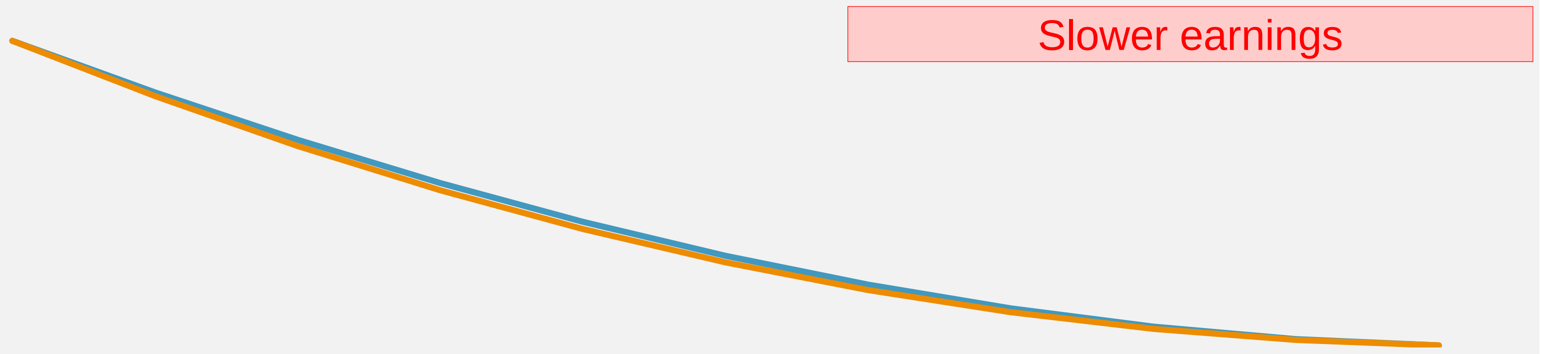


Case B: DAC or VOBA for an older in-force block

FAS 60: Interest accrual is applied to amortization factor and DAC roll-forward calculation

LDTI: Interest accrual is not applied to amortization factor and DAC roll-forward calculation

Conclusion: Exclusion of interest accrual under LDTI speeds up amortization slightly; this can be more impactful for an in-force block with little to no future deferable costs

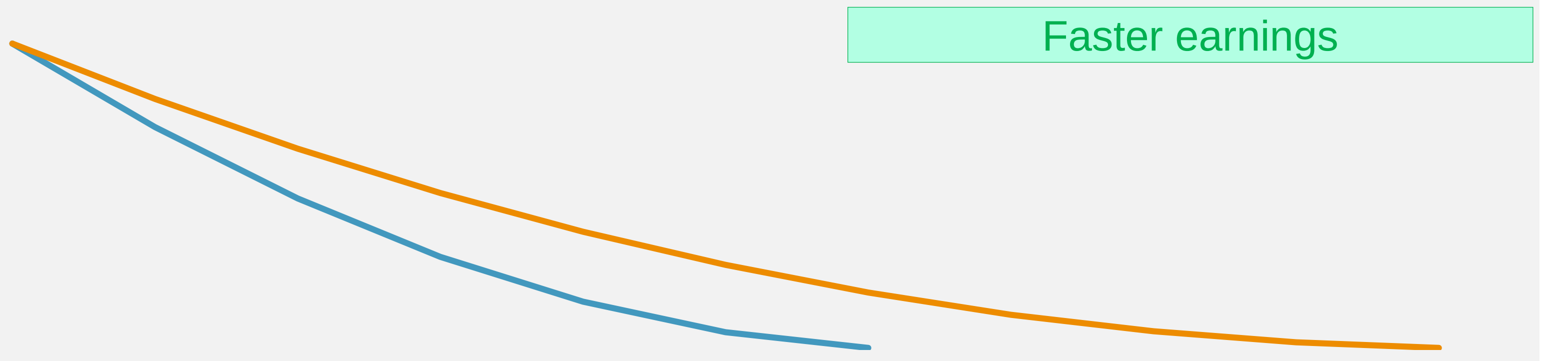


Case C: VOBA for an older in-force block with lifetime claims

FAS 60: Intangibles amortized over the active phase of the contract only

LDTI: Intangibles amortized over the active and disabled phase of the contract

Conclusion: The interpretation of LDTI to mean active and disabled phases of the contract represent a single “unit of account” can lead to slower amortization, particularly for a block of business with claims that extend well beyond the active life maturity date



Case Study 3: Delayed Rate Increases

Situation

An LTC carrier reflected expected rate increases to be approved prior to Q1 reporting. However, **approval of the rate increases was delayed, meaning only $100 of premium was collected instead of the $150 that was expected**. All other experience emerged in line with expectations.

	FAS 60		LDTI	
	Expected	Actual	Expected	Actual
Premiums	**150**	**100**	**150**	**100** A
LFPB beginning of period	280	280	280	280
(+) Impact of experience variance	-	-	-	16 B
(+) Net premium collected	114	114	114	79 C
(-) Reserve released on benefits	150	150	150	150
LFPB end of period	244	244	244	225
(+) Premium	150	100	150	100
(-) Benefits	150	150	150	150
(+) Reserve release	36	36	36	55
Net income	**36**	**(14)**	**36**	**5** D

Commentary

- **A** Gross premium revenue received was expected to be $150; however, approval of the rate increase was delayed, resulting in only $100 of premium being collected
- **B** Retrospective unlocking under LDTI reflects lower premium than expected, increasing the reserve measured at beginning of period
- **C** LDTI reflects actual premium in the roll-forward of the reserve, while FAS 60 reflects expected premium

Conclusion

- **D** Retrospective unlocking and reflection of historical cash flows under **LDTI dampens the financial impact of adverse experience by spreading out the volatility over time**

Case Study 4: Unexpected Termination Event

Situation

An individual disability insurer experienced **significantly higher terminations than expected, causing a $20 decrease in disabled life reserves**. All other experience emerged in line with expectations.

	FAS 60		LDTI	
	Expected	Actual	Expected	Actual
Present value of benefits	**550**	**530**	**550**	**530** A
LFPB beginning of period	313	313	313	313
(+) Impact of experience variance	-	(20)	-	(10) B
(+) Net premium collected	73	73	73	71
(-) Reserve released on benefits	125	125	125	125
LFPB end of period	260	240	260	248
(+) Premium	100	100	100	100
(-) Benefits	125	125	125	125
(+) Reserve release	53	73	53	65
Net income	**28**	**48**	**28**	**40** C

Commentary

A Unexpectedly high terminations cause a $20 release in disabled life reserves

B Under both LDTI and FAS 60, the terminations result in a $20 DLR release; however, under LDTI, the net premium ratio unlocks to reflect lower than expected benefits, decreasing the amount of premium included in the reserve and creating an offsetting increase to ALR

Conclusion

C Retrospective unlocking and reflection of historical cash flows under **LDTI dampens the financial impact of positive experience by spreading out the volatility over time**

Industry Snapshot and Day 2 Items

State of the Industry: Status

The industry is currently shifting focus from complying with LDTI to assessing its implications and prioritizing refinements

LDTI enablement steps

4. Go-live

Report GAAP under LDTI as of Q1 2023, including LDTI financial statements and enhanced disclosures for transition, comparative runs, and the current period

3. Validation and parallel testing

Develop framework and execute end-to-end process validation to ensure company is ready for execution of comparative financials and go-live

2. Implementation

Design, build, and iterate on pre-model, model, and post-model processes, and perform operational dry runs

1. Planning and decision making

Build and iterate on project / resource plan and make / document accounting policy decisions to prepare for an efficient implementation with minimal uncertainty

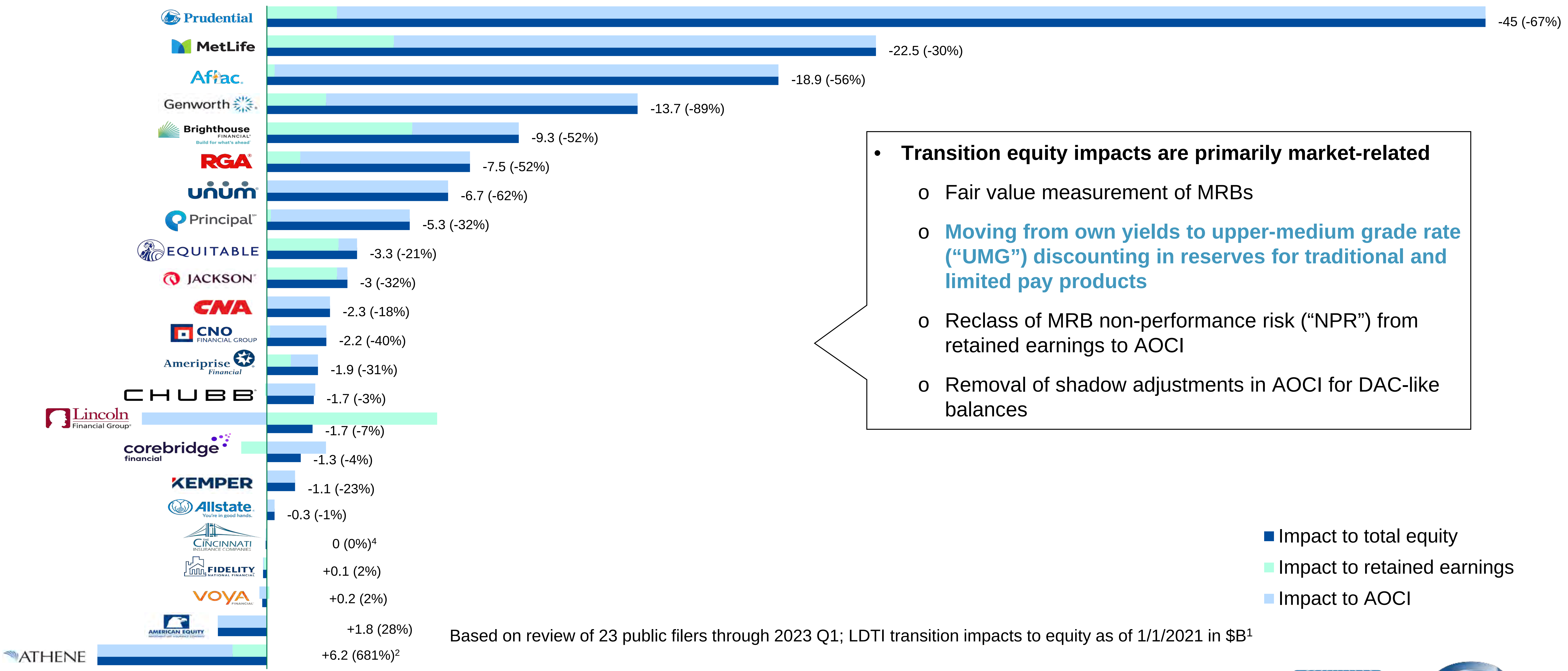
Day-2 items

As public companies go live with a compliant LDTI process at Q1 2023, many are shifting gears to work through prioritization and execution of Day-2 items, including but not limited to:

- Assessment of go-forward financial impact
- Management reporting and internal analysis
- Financial planning and analysis ("FP&A")
- Non-GAAP operating earnings adjustments
- Transformation and automation
- Pricing, reinsurance, and mergers and acquisitions

LDTI Impacts: As Of Transition Date

Majority of companies noted negative equity impacts at transition due to the market environment as of beginning of 2021



- **Transition equity impacts are primarily market-related**
  - Fair value measurement of MRBs
  - **Moving from own yields to upper-medium grade rate ("UMG") discounting in reserves for traditional and limited pay products**
  - Reclass of MRB non-performance risk ("NPR") from retained earnings to AOCI
  - Removal of shadow adjustments in AOCI for DAC-like balances

Based on review of 23 public filers through 2023 Q1; LDTI transition impacts to equity as of 1/1/2021 in \$B[1]

[1] % impacts are estimated as LDTI impact divided by total shareholders' equity as of 12/31/2020
[2] Cincinnati Financial Corporation and Athene's transition impacts are as of 12/31/2022

LDTI Impacts: Earnings Releases

Many companies have reported positive all-in earnings as interest rates have increased since LDTI transition

- **65% of companies reported higher earnings under LDTI during the first comparative period presented[1]**
  - Positive earnings impacts largely driven by market risk benefits ("MRBs"), as companies recoup the reduction in equity at transition
  - The next most common driver is lower DAC amortization
- **78% have changed non-GAAP operating adjustments**
  - Most common changes relate to MRBs or reinsurance
  - Companies without changes have limited exposure to MRBs or business affected by LDTI adoption

Based on review of 23 public filers through 2023 Q1; LDTI impacts to net income (%)[1] during Q1 2022[2]

[1] % impact is estimated as change in net income divided by net income prior to adoption of LDTI
[2] Net income impacts for Brighthouse and RGA are for full year 2022

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LDTI Overview: High-Level Implications

LDTI results in major changes to the status quo across multiple functions, with many implications yet to be fully understood

Data

Large volume of additional granular data that was not needed in the past, requiring more complex data solutions with more collaboration between IT and actuarial

Modeling

Multiple model runs to inform expanded roll-forward disclosures and more computationally intensive stochastic model runs for market risk benefit ("MRB") valuation (more applicable for guaranteed benefits on annuities)

Valuation

Strain on existing valuation timelines due to additional data reliances and more computationally-intensive model runs, necessitating automation and streamlining

Reporting

Expanded disclosures create more detailed information for internal and external consumers of the financials along with additional control points

Earnings

The additional earnings volatility for some products creates the need for enhanced analytics and granular reporting metrics in order to understand drivers of earnings and inform business decisions

Management

LDTI changes and their earnings implications have the potential to impact existing strategy for pricing, reinsurance, and mergers and acquisitions

Day 2 Items: Management Reporting and Internal Analysis

Companies are leveraging additional data and model runs required by LDTI to augment existing analysis and support business management

Emerging trends	
1	Most companies are leveraging LDTI disclosures to **supplement existing management reporting framework**
2	Some companies are planning to use the additional model runs required by LDTI to develop detailed **source of earnings analysis**
3	Companies who are developing source of earnings analysis have cited **disaggregation of experience variance into components** (mortality, lapse, etc.) as a key requirement that's been challenging to execute on
4	Many companies are using **sub-cohorts to drill down into results**; a subset have chosen to recalculate K-factors at a sub-cohort level to provide more meaningful results at a granular level
5	Many companies expect the **first few reporting periods to set the tone** for LDTI's influence on internal reporting
6	Many companies are developing management reporting and other **analytical exhibits using visualization tools (e.g., Tableau, PowerBI)**; many have cited the data model supporting visualization tools as a key focus area

Day 2 Items: FP&A and Non-GAAP Adjustments

LDTI has major implications on FP&A and performance measurement

For companies who conduct FP&A using GAAP income or a derivative of GAAP income, LDTI will need to be considered in **FP&A processes and targets**

FP&A processes

LDTI presents challenges to existing FP&A processes:

1. Post-model / topside adjustments to FP&A projections are more challenging under LDTI due to retrospective unlocking
2. Assigning LFPB discount rates for future new business in FP&A projections requires an assumption for future upper medium grade discount rates

However, LDTI also presents opportunities for FP&A:

1. With more GAAP calculations now based on best estimate projections, there may be opportunity to better align assumptions, methodologies, and software platforms between valuation and FP&A
2. Granular data required for LDTI can be leveraged to develop detailed, actionable source of earnings analysis
3. Updating FP&A processes to incorporate LDTI may be a good opportunity to automate and streamline FP&A processes more broadly

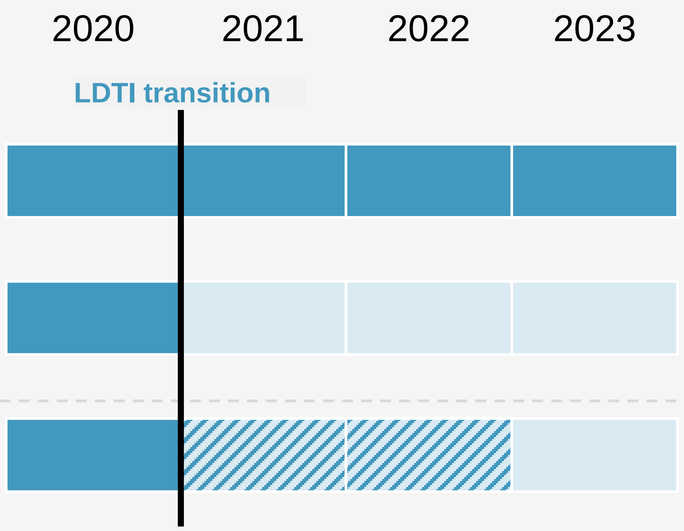
Non-GAAP adjustments

1. Many companies are planning to reflect or have already begun reflecting adjustments to remove market volatility from change in LFPB and achieve mirrored reinsurance accounting

FP&A targets

Some companies have or are planning to recast prior year(s) financial plan projections under LDTI to provide an apples-to-apples basis for comparing actuals to plan targets

Illustrative approach: recasting 2020 FP&A cycle under LDTI with 1/1/2023 adoption date, 2 years of comparative financials, and assuming a 3-year forecast



Step 1: Produce financial plan on a pre-LDTI basis

Step 2: "Recast" financial plan with LDTI transition reflected

Step 3: Compare to actuals

Current GAAP | Comparative financials period | LDTI

Regardless of whether adjustments to existing financial plan targets are warranted or appropriate, companies have found **recasting prior years' financial plan projections can provide valuable insight as to the directional impact of LDTI**

Day 2 Items: Transformation, Pricing, Reinsurance, and M&A

As the industry achieves compliance, focus will continue to shift towards LDTI's impact on strategic initiatives

1

Pricing

For business with material LDTI impacts, matching pre-LDTI earnings patterns may require adjustments to pricing / structuring of fees

2

Reinsurance and M&A

- Earnings patterns associated with existing reinsurance may change under LDTI
- Lines of business with less desirable earnings patterns and/or additional volatility under LDTI may become candidates for reinsurance and M&A transactions
- Lack of reserve mirroring under LDTI may impact strategy and pricing (e.g., companies may prioritize sale over coinsurance of blocks)

3

Transformation

- Additional automation of LDTI processes may be required to balance data, processing, and disclosure requirements with existing close timelines
- Many companies with ongoing actuarial modernization initiatives have had to go live with interim solutions that will need to be refined to align with the future-state vision for transformation

Thank You

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