Analysts expect more clarity from LDTI

In our survey of insurance analysts, we find that analysts want to hear more from insurers about how they will implement ASU 2018-12, and they expect that the new reporting standard will help make life insurers' financial statements more understandable.

What do industry analysts, ratings agency analysts, and investment bank analysts expect to learn about life insurers' financials after the Financial Accounting Standards Board's Accounting Standards Update No. 2018-12 (ASU 2018-12) is adopted? The update, better known as Long-Duration Targeted Improvements (LDTI), is arguably the most significant change to U.S. insurance accounting in over 30 years. Moreover, the new rule will have ramifications well beyond accounting; it almost certainly will have substantial impacts on the data, systems, controls, and processes used to measure and report insurers' financial results.

KPMG surveyed analysts from insurance industry research firms, rating agencies, and investment banks to understand what information they want from life insurers—in particular, what information they need to compare performance between companies. The much-debated and unquestionably complex new standard revises accounting rules under U.S. generally accepted accounting principles (US GAAP) for a host of long-duration insurance contracts, such as traditional and limited-pay life policies, fixed and variable annuities, disability-income policies, and more.

Our purpose in offering this report is to share insights from our survey on how analysts view insurers' progress on implementation of the standard. We also sought insights into how insurers can use the standard's requirements to address analyst concerns (and those of regulators and investors) about the quality of financial reporting.

The road to implementation will be long, the costs will be significant, and the standard will present complex challenges for insurers. Nevertheless, we believe the rule also presents opportunities for providing financial statement users with more useful information about the amount, timing, and uncertainty of cash flows related to long-duration contracts as insurers will be required to review and revise assumptions and calculations relating to such financial measures as cash flows, the measurement and impacts of certain risks and benefits, and enhancement of certain disclosures.

As always, we offer this report in the spirit of debate. We understand—and, frankly, hope—that some of our conclusions will be challenged by our readers. Our intention is for these observations to generate conversations between insurance professionals and industry participants. To that end, we welcome your feedback.

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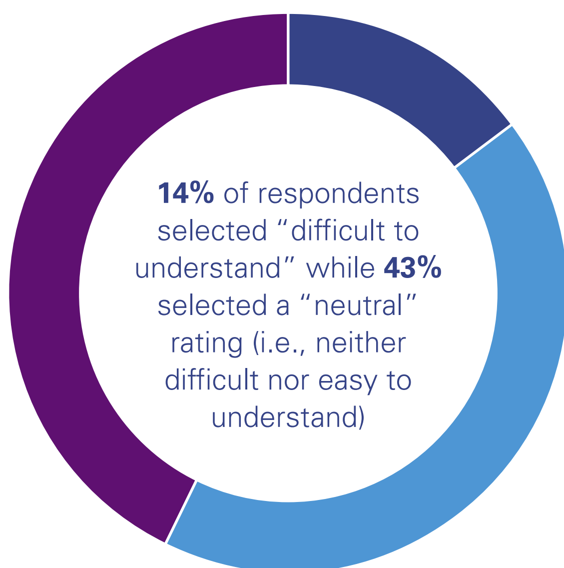
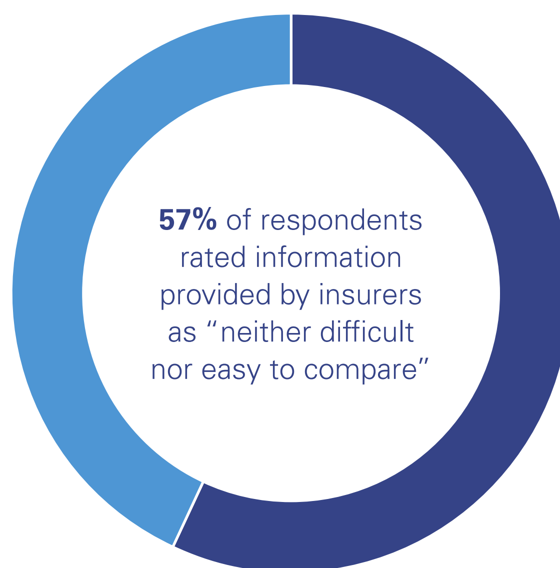
More clarity, please

Life insurance analysts in our survey had mixed views of the job life insurers currently perform in providing comprehensible information about insurers' financial performance—14 percent said the information is "difficult to understand" and 43 percent said the information is "easy to understand" with the rest on the fence. Also, 57 percent of analysts said they found it neither difficult nor easy to compare insurers' financials across industry participants. However, they're most concerned about divergent valuation methods applied by insurers. Although not required by LDTI, disclosures and performance measures on a normalized basis are widely sought by analysts to assist in comparisons across insurers.

Regarding information currently provided by insurers on their financial performance, how understandable do analysts and rating agencies think the information is?



How do analysts and rating agencies rate the comparability of financial performance information provided by insurers under current US GAAP?



Complaints by analysts and investors that insurer financial statements "are impenetrable to all but the most seasoned experts"[1] are nothing new. Existing rules typically do not require assumptions to be reevaluated unless policies start losing money, meaning the assumptions used in current reporting could be significantly outdated. FASB's new accounting standard requires insurers to "at least annually or as needed, review assumptions about cash flows and also update the discount, or interest rates, they use to make those calculations."[2]

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[1] "Insurance Companies to Get Breathing Room on Accounting Overhaul," Bloomberg Tax, July 18, 2019

[2] Ibid.

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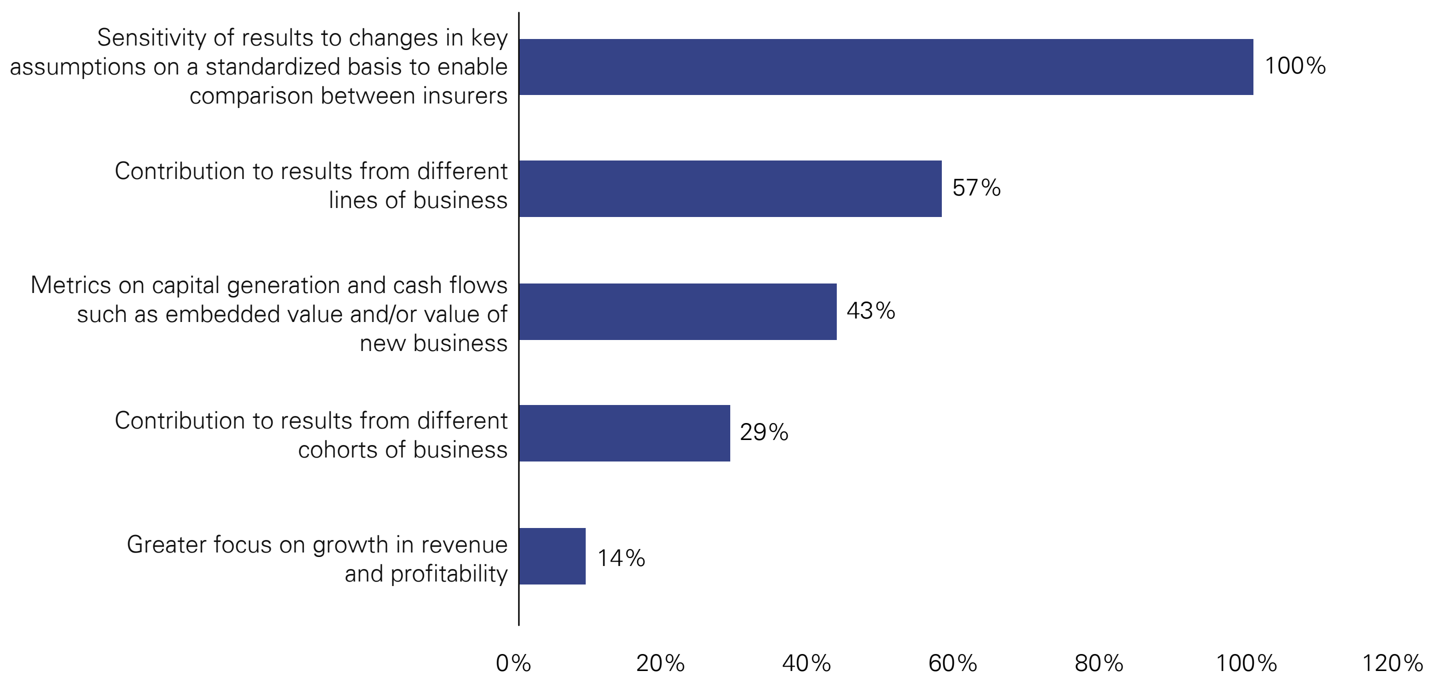
What specific disclosures do analysts want most?

When we asked analysts to provide details about what would constitute greater clarity, the No.1 response—cited by every respondent—was information on the sensitivity of results to changes in key assumptions, which helps analysts make clear comparisons of insurer results. A majority of analysts are also seeking information on how different lines of business contribute to results.

What additional disclosures do analysts and rating agencies believe would help insurers better communicate their financial performance?



Survey respondents were also unanimous in their desire to see early insights from LDTI implementation. Specifically, analysts expect high-level directional impacts of ASU 2018-12 on insurers' results and balances prior to the effective date of the standard.

Given that adoption for ASU 2018-12 is mandatory for fiscal years beginning after December 15, 2022 for SEC filers, excluding entities eligible to be smaller reporting companies as defined by the SEC, 71 percent of analysts expect insurers to share impact information in the second half of 2021 while the rest anticipate impact information in the first half of 2022.

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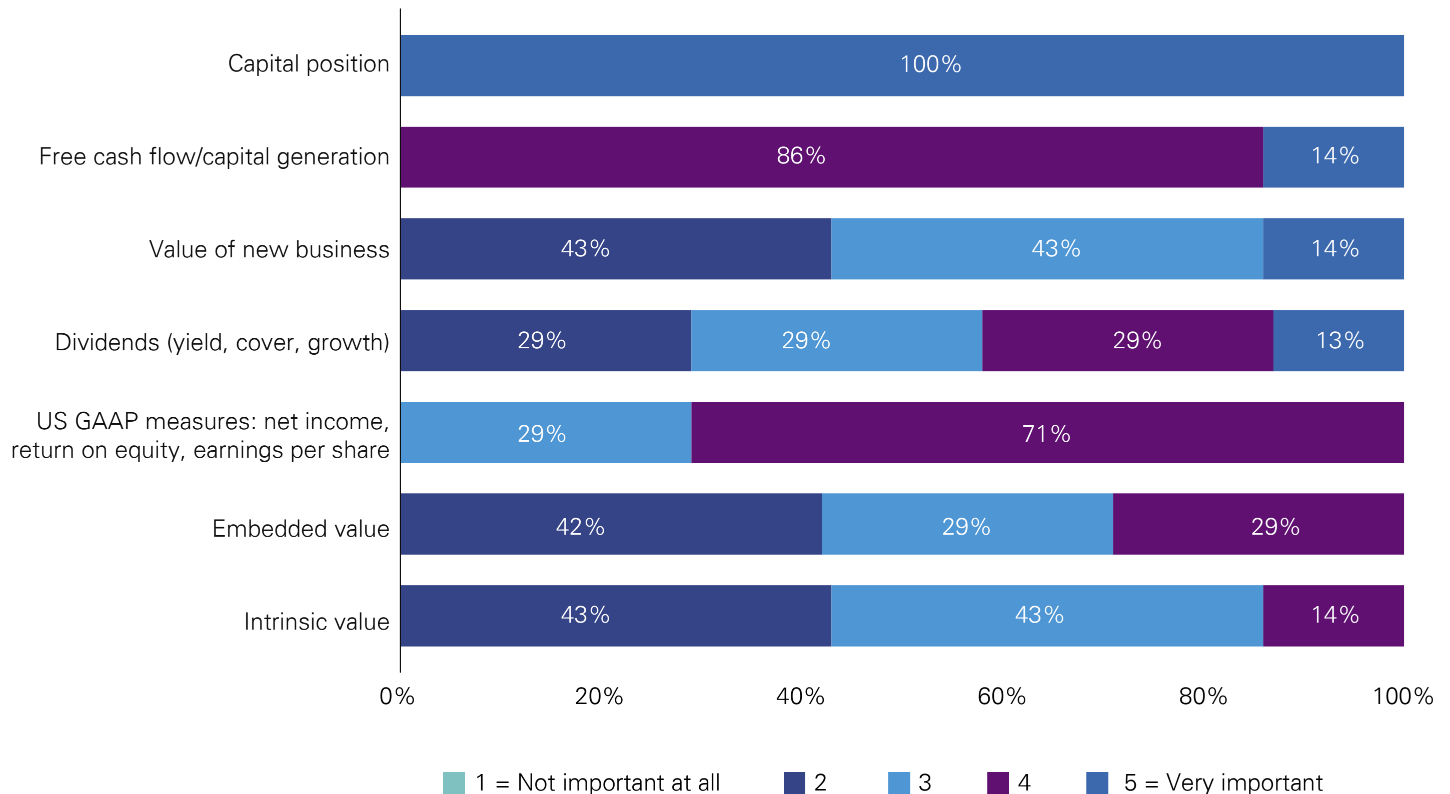
Top metrics used by analysts

Foremost among metrics analysts say they use for evaluating insurers' financial performance were capital position, free cash flow/capital generation, value of new business, and dividends (yield, cover, growth).

Under current GAAP, what level of importance do analysts and rating agencies place on select metrics when evaluating an insurer's financial performance?



The analysts also said the following performance measures (listed in order of importance) are vital to perform their analyses:

Return on equity

Income before taxes

Earnings per share

Net income

When asked to rank the importance of non-GAAP measures, adjusted earnings was the key indicator rated as very important by 80 percent of analysts. In second place, 42 percent of analysts selected adjusted premiums, fees, and other revenue as very important.

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Top concerns about comparability

Comparability is a major issue for analysts. When we asked what metrics were most concerning when it comes to comparability, every respondent said they were either "very concerned" or "concerned" with variation in approaches used by insurers to set discount rates. The next biggest area of concern was inconsistent valuation methodologies (86 percent), followed by approaches used when setting reserve assumptions (83 percent).

How concerned are analysts and rating agencies with respect to comparability of US GAAP financial information produced by insurers?

	Different approaches to setting reserve assumptions	Different approaches to setting discount rates	Valuation of financial options and guarantees	Use of inconsistent valuation methodologies
5 = Very concerned	43%	29%	14%	14%
4	43%	71%	57%	72%
3	14%		29%	14%
2	0%			
1 = Not concerned at all	0%			

When asked what their primary concern is with respect to financial information produced by insurers and noninsurers, 71 percent specified inconsistency between the asset and liability current measurement while 29 percent indicated the information produced by insurers is too complex.

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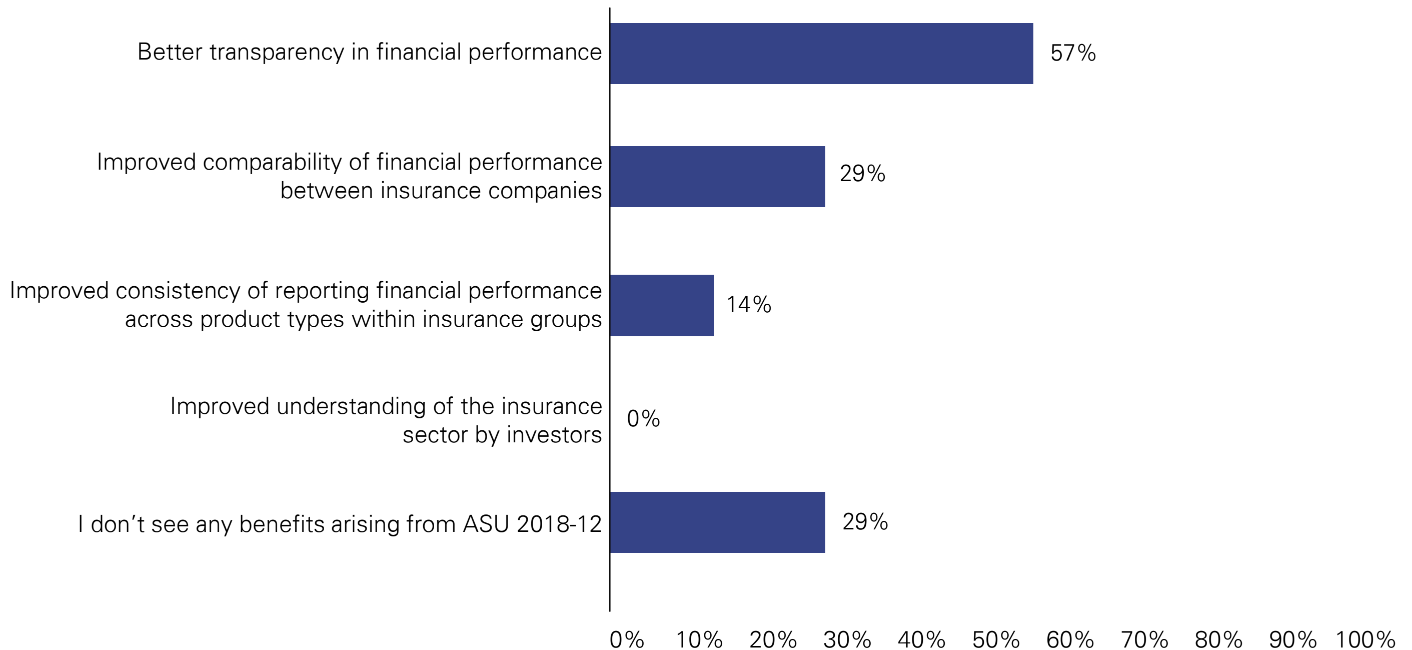
Looking forward: Expectations for LDTI

The majority of analysts indicated the main benefit of the new standard will be enhanced clarity into financial performance (57 percent). Other expected benefits include better comparability among insurers, improvements in investor understanding of metrics, and reporting consistency across product types. However, nearly one-third—29 percent—said they expect no benefits from the implementation of ASU 2018-12.

What do analysts and rating agencies believe to be the main benefits arising from ASU 2018-12, if any?



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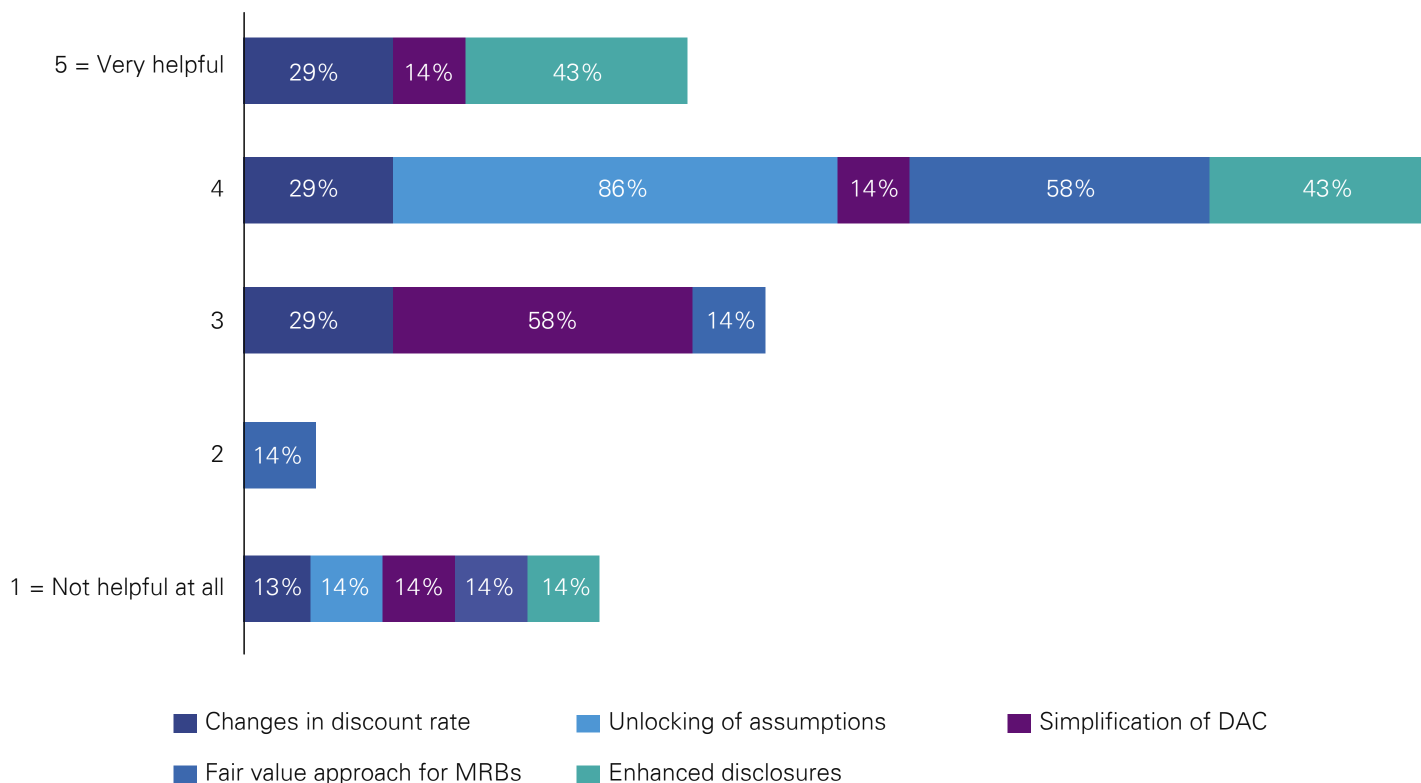
Ranking assessment of financial performance

Analysts said they see a variety of benefits accruing from changes in the accounting treatment of long-duration contracts. A large majority say the standard will be helpful relating to expanded disclosures, unlocking and updating of cash flow assumptions used to measure the liability for future policy benefits, a consistent (i.e., fair value) approach to measuring market risk benefits, and understanding the impact of changes in the discount rate.

They also say the new standard will be helpful in simplifying the amortization of deferred acquisition costs.

How do analysts and rating agencies view the changes arising from ASU 2018-12 as it relates to their assessment of an insurer's financial performance?



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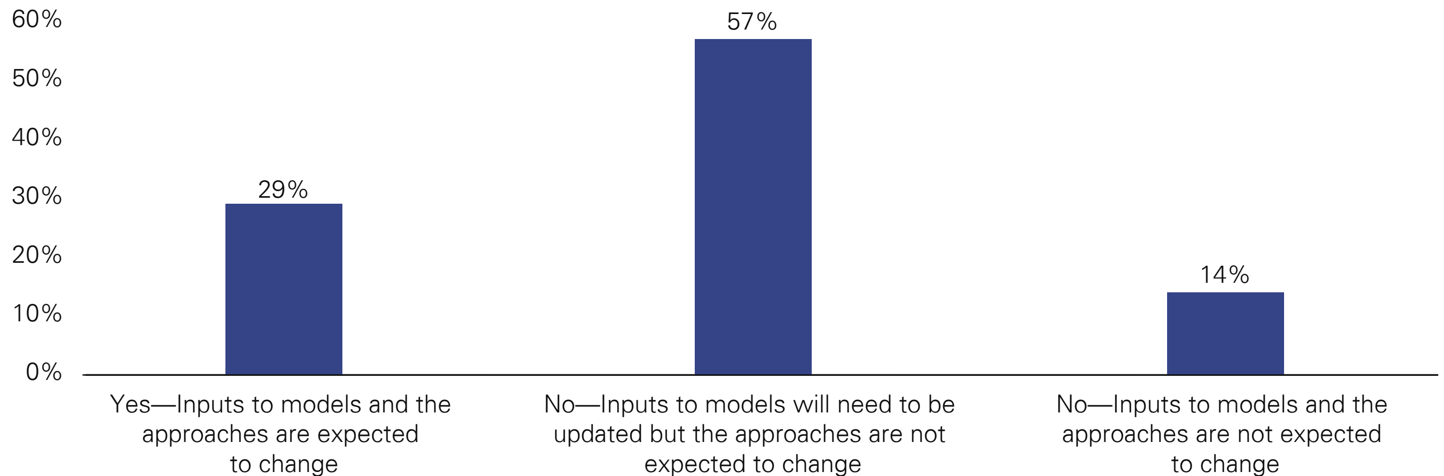
Analyst model updates for LDTI

Modeling is a critical tool for valuing insurers, so we asked analysts whether they would change any approaches they employ in their valuation inputs and/or methods as a result of LDTI. While the majority (57 percent) of analysts said they will not necessarily change their valuation approaches, they said that inputs to models will need to be updated due to certain elements in the new standard. Additionally, 29 percent of analysts said they anticipate changes to both their valuation models and inputs to models, and the remaining 14 percent are not changing either their models or inputs.

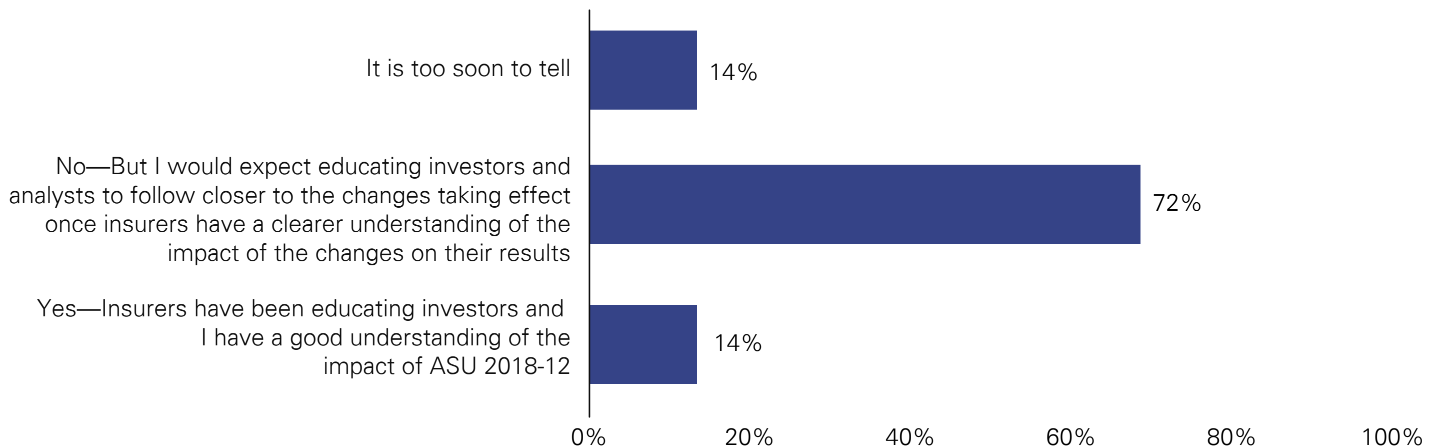
Do analysts and rating agencies expect ASU 2018-12 to change the approaches used to value insurers?



Call to action: More analyst education

The survey respondents have a clear message: Insurers are not doing enough to educate them about the impact of LDTI changes on results (72 percent). This is despite the fact that 86 percent of respondents say they have been engaged in dialogue with insurers on LDTI implementation progress. However, respondents say they do expect more discussions about impact to take place closer to the effective date, when insurers have a clearer understanding of the impact of such changes. The take-away: Insurers should make sure they put sufficient effort into educational efforts.

Do analysts and rating agencies believe that insurers are doing enough to educate them about the impact of these changes on their results?



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How can KPMG Help?

The KPMG insurance accounting change methodology acts as a compass to help ensure that insurers ask and answer the right questions about implementation, including questions about program interdependencies and the broader business implications brought on by the change.

KPMG has a cross-functional team of subject matter professionals ready to provide your company with a suite of services needed to smoothly implement LDTI. This team consists of technical accounting, actuarial, data, financial transformation and other insurance sector specialists with deep experience in their respective fields. Each of these specialties are individually important to the accounting change, but also have key interdependencies that must be considered throughout the entire implementation process.

KPMG professionals will begin their hypothesis-driven approach in a top-down rather than bottom-up gap analysis to help ensure a robust yet cost-effective transition to LDTI that will result in full compliance with the accounting change. With deep market insights from advising many leading insurers on LDTI implementation, our insurance sector specialists will leverage previous lessons learned to develop a tailored action plan. This plan will consider the complexity of each area of change and the existing gaps in actuarial and accounting processes and will communicate the magnitude of effort required to bring your company's current-state environment into compliance with LDTI.

Our insurance accounting change team can bring you insights every step of the way by actively promoting knowledge transfer to your people from the outset, which will provide you with a sound base of knowledge to deliver the new ways of working. This value-added service will help ensure that, after the conclusion of your tailored LDTI implementation, the key stakeholders in your business are fully equipped to maintain processes, account and report in a manner that is in full compliance with regulations and provides maximal value to your investors.

Throughout the implementation, our professionals will help you understand, prepare, and address the complex challenges presented by LDTI by leveraging our tailored methodology that considers the impact of LDTI for your business in a structured way. This structure will provide advice in a manner that is tailored specifically to your business and strategic objectives.

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