Analyst trends in LDTI

Insurance analysts we surveyed still want to hear how ASU 2018-12 is impacting insurers. Specifically, they want more detail on how the new reporting standard will help make life insurers' financial statements more understandable but worry it may cause earnings volatility.

Industry analysts, ratings agency analysts and investment bank analysts have now had multiple years of discussion and research since the issuance of the Financial Accounting Standards Board's Accounting Standards Update No. 2018-12 (ASU 2018-12).

What has changed in their views, what has not, and what do they expect? Our purpose in offering this report is to share insights from our surveys, with a focus on the current 2023 survey, on what analysts view as important including key metrics and performance measures. We hope that this report gives insurance companies and analysts alike a glimpse into what is valued from the new guidance.

The update, better known as Long-Duration Targeted Improvements (LDTI), is arguably the most significant change to U.S. insurance accounting in more than three decades. LDTI became effective on January 1, 2023 for SEC filers, excluding smaller reporting companies as defined by the SEC. This unquestionably complex standard revises accounting rules under U.S. generally accepted accounting principles (US GAAP) for long-duration insurance contracts, such as traditional and limited-payment life contracts, fixed and variable annuity contracts, disability-income contracts, and more. The new standard, which is targeted, yet not simple, has had ramifications well beyond accounting; it has certainly had substantial impacts on the data, systems, controls, and processes used to measure and report insurers' financial results.

Since 2019, KPMG has surveyed analysts from insurance industry research firms, rating agencies, and investment banks to understand what information they want from life insurers, and, in particular, what information they need to compare performance between companies in the industry.

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

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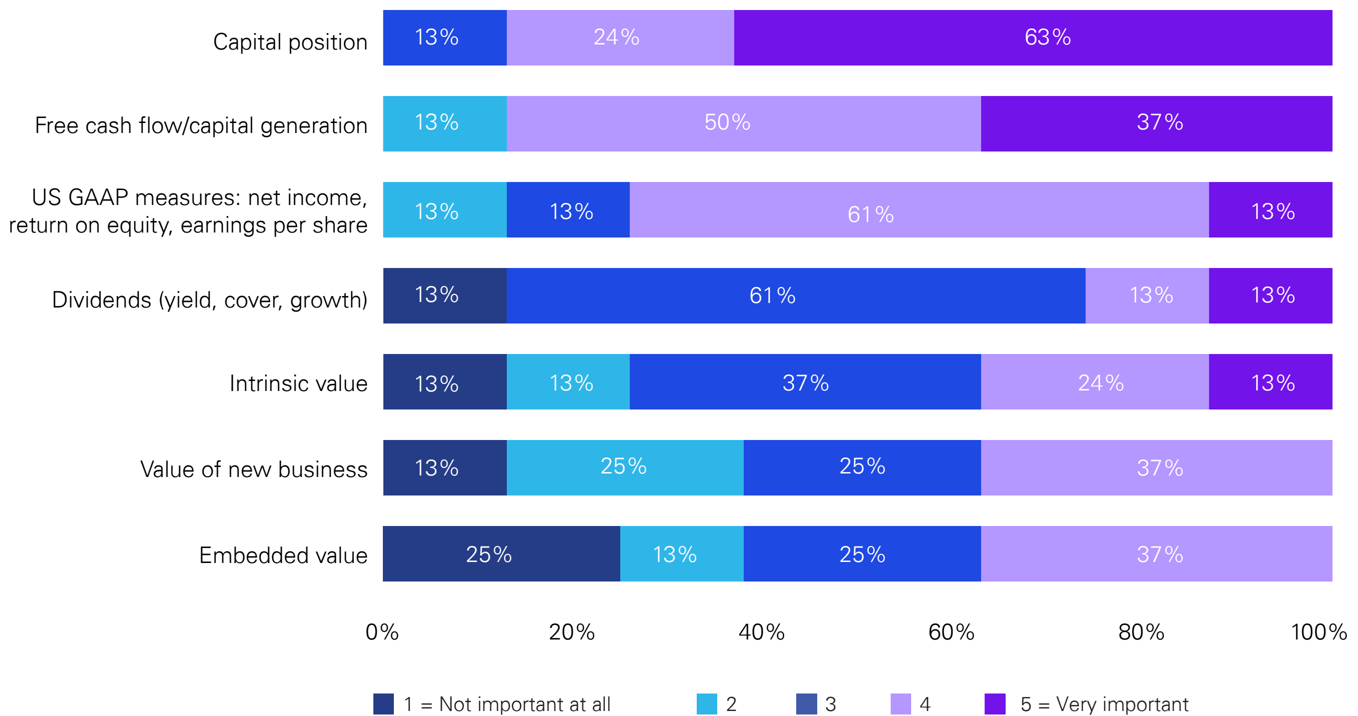
What has remained important?

Over five years of surveys, capital position has consistently been the top key metric analysts use for evaluating insurers' financial performance and is demonstrated below in the 2023 survey. Free cashflow/capital generation has consistently remained the second most important metric. There is less agreement among analysts on what is the third most important metric. In previous surveys, third place has gone to US GAAP measures such as net income, return on equity, earnings per share, dividends (yield, cover, growth), and intrinsic value.

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



In addition to key metrics, the analysts have rated the following US GAAP performance measures in terms of importance to their analyses.

1. Income before tax
2. Return on equity
3. Earnings per share
4. Net income

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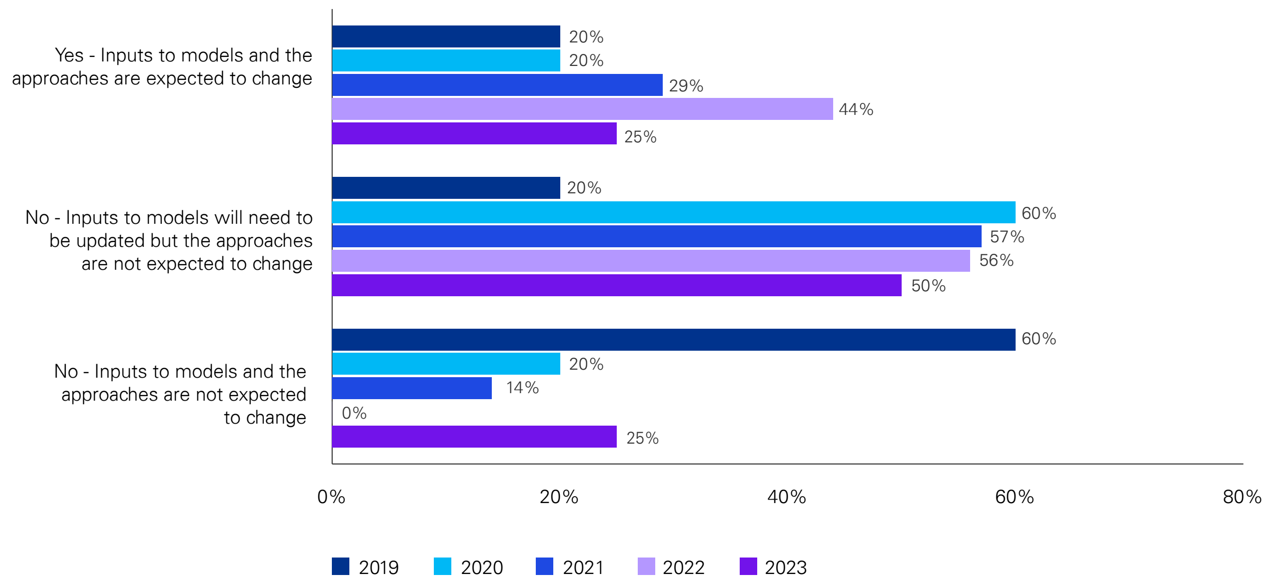
Are analyst models changing?

For the past five years, we have asked analysts if they expect changes to their approaches to valuing insurers. Since 2020, at least half of analysts have said that, while approaches to valuation models will not change, inputs to the models will need to be updated. Fewer analysts expect both inputs to the models and the approach will change due to LDTI.

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



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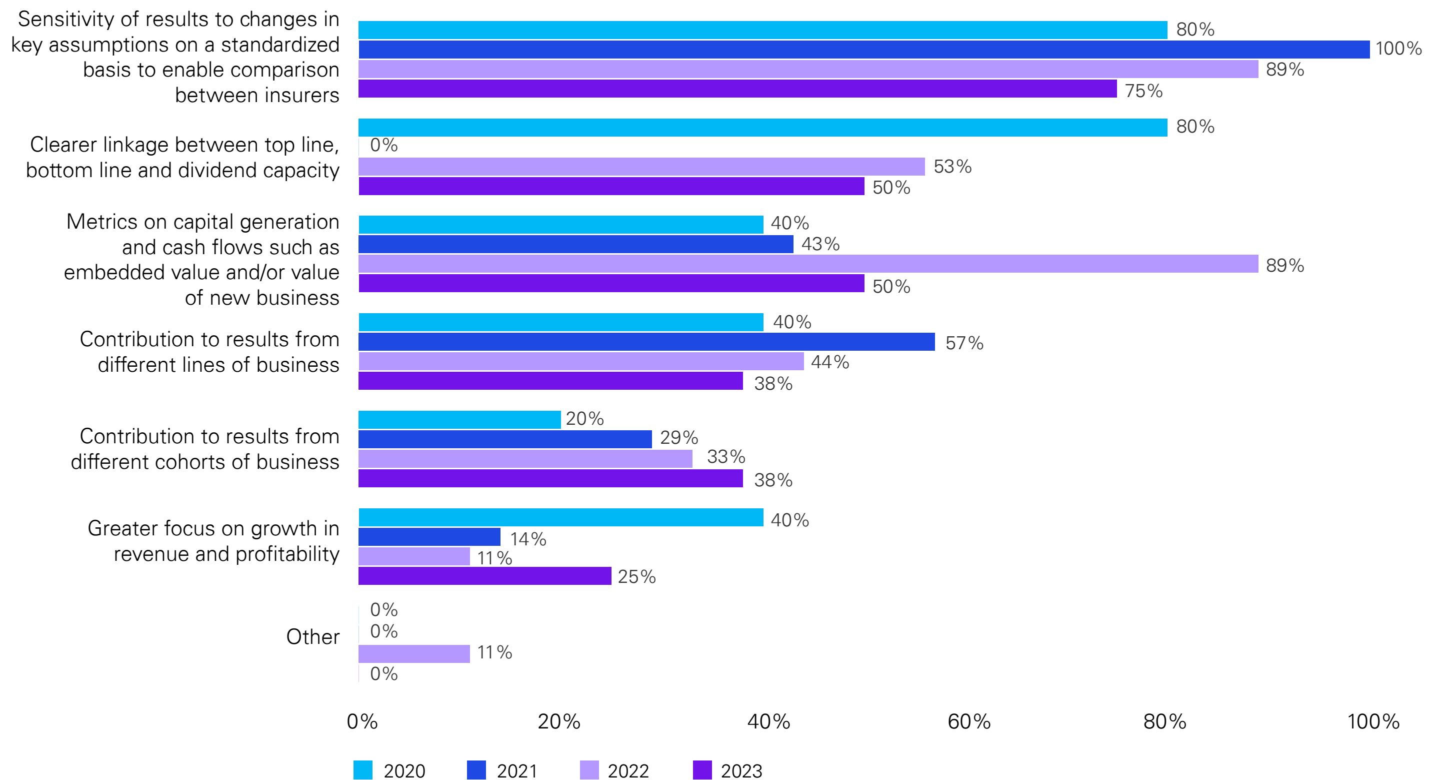
What information is most helpful?

What details about LDTI changes are helpful for their analysis? Among the top changes cited are: unlocking of assumptions, fair value approach for market risk benefits (MRBs), simplification of deferred acquisition costs (DAC), and changes in discount rates. However, for most analysts, the most helpful change is the enhanced disclosures required by LDTI. Half of the 2023 survey respondents said enhanced disclosures are "very helpful" for their assessment of an insurer's financial performance and another 38 percent said enhanced disclosures are "helpful."

Given the value analysts' place on the enhanced disclosures and information such as unlocking of assumptions, it is no surprise that when we asked analysts to provide details about what type of additional disclosure would constitute greater clarity, the top response each year—cited by a majority of respondents—was information on the sensitivity of results to changes in key assumptions, which enables clearer comparisons of results between insurers.

What additional disclosures do analysts and rating agencies believe would help insurers better communicate their financial performance?[1]



[1] Respondents were asked to select all that apply.

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Is there a preferred accounting basis?

During the last five years, analysts have gradually changed their minds about the weight they place on different accounting bases (regulatory reporting, US GAAP, or alternative measures) used to value insurance companies. Over time, analysts have decreased their emphasis on regulatory reporting, and indicated that all three accounting bases are equally important.

What is the relative weight in their analyses that analysts and rating agencies expect to attach to regulatory reporting results reported using US GAAP and alternative performance measures such as intrinsic value reporting?

	2019	2020	2021	2022	2023
All three are expected to be equally important	0%	40%	14%	56%	63%
Regulatory reporting is expected to be most important because, among other reasons, it directly influences regulatory capital and hence dividend capacity	42%	40%	72%	22%	24%
US GAAP is expected to be most important because, among other reasons, it aims to provide a consistent approach to performance reporting by insurers	0%	20%	0%	11%	13%
Alternative performance measures are expected to be the most important because, among other reasons, it can be modified to reflect the particular circumstances of each insurer	29%	0%	0%	0%	0%
Not sure / Too soon to tell	29%	0%	14%	11%	0%

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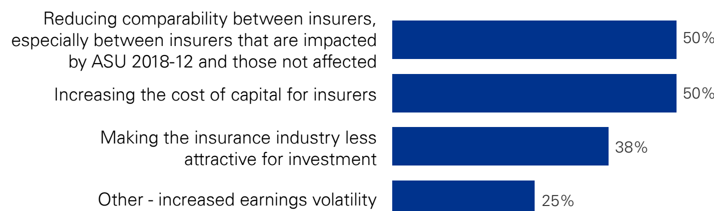
Are there any adverse consequences?

Changes to the liability for future policyholder benefits under LDTI will mainly impact traditional and limited-payment long-duration contracts such as term life, whole life, life-contingent payout annuities, and single-premium immediate annuities. The most significant changes to reserving for these products are:

1. Cash flow assumptions are reviewed annually at the same time every year and assumptions are updated if there is a change, unless experience suggests more frequent updates
2. The discount rate is an upper-medium grade (low-credit-risk) fixed-income instrument yield updated each reporting period, with the changes in discount rate included in accumulated other comprehensive income (AOCI)
3. Grouping of contracts for reserve calculations into cohorts by at least issue year

The measurement of universal life liabilities is unchanged by LDTI leaving an asymmetry issue between assets that are accounted for as available for sale (AFS) with changes in fair value recognized in accumulated other comprehensive income (AOCI) and universal life liabilities that are not subject to LDTI's discount rate requirement. As such, while some insurers will be operating under the new standard, there are others that are not impacted by ASU 2018-12 depending on their product set. Analysts have expressed concern with the comparability between insurers accounting under two sets of standards. In our 2023 survey, 50 percent cited this as a potential adverse consequence. Interestingly, in comparing the survey results split between institutional investors and rating agencies, 75 percent of institutional investors expressed concern over a reduction in comparability while only 25 percent of rating agencies noted this concern. Additionally, 50 percent overall are also worried about the increasing cost of capital for insurers.

What are the potential adverse consequences of ASU 2018-12?[1]

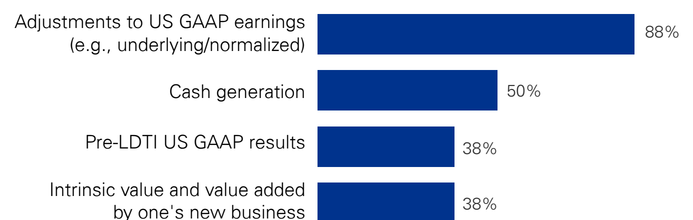


How can insurance companies help?

Under LDTI, volatility of earnings due to frequent unlocking of assumptions and fair value measurement of MRBs are expected to impact profit emergence of impacted products. To help mitigate the added challenge, we asked the analysts what additional information would be helpful.

In 2023, 88 percent of analysts said they expect there will be greater need for supplementary reporting of additional performance measures as a result of LDTI. Not a single analyst said there would be a need for less supplementary reporting. When asked about what specific performance measures would be useful, almost every respondent said performance measures on a normalized basis would assist in comparisons across insurers.

What additional performance measures are useful?[1]



[1] Respondents were asked to select all that apply.

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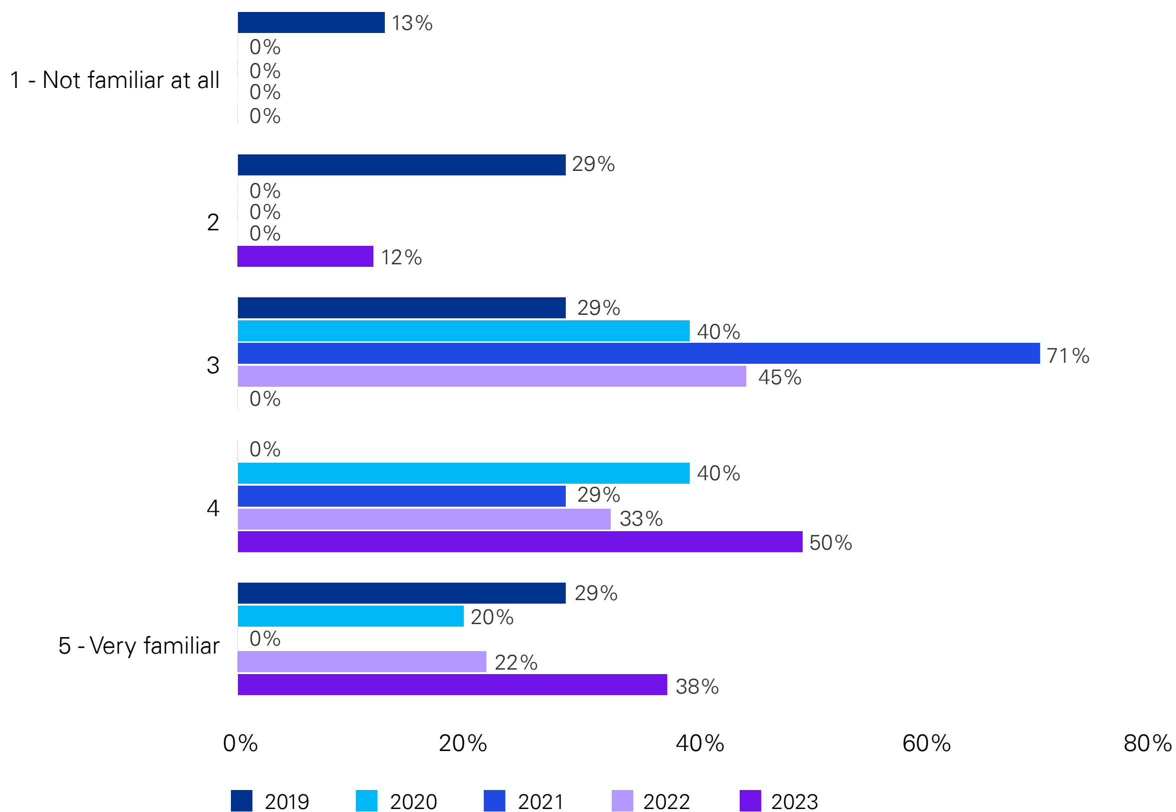
How has familiarity with LDTI progressed?

When we first asked analysts to rate their familiarity with the new standard in the months following the issuance of ASU 2018-12, the responses spanned the full range between 1 to 5 on a scale of 1 being "not familiar at all" and 5 being "very familiar." Interestingly, while there were some analysts who said they were very familiar with LDTI in 2019, none said they were very familiar in 2021 with a majority of respondents stating they were either "familiar" or "not familiar." In 2022, analysts demonstrated progress in their LDTI familiarity, a trend that continued in 2023 with 88 percent stating they were "familiar" or "very familiar."

What can we draw from the survey results? It is safe to say that the word "targeted" in the name of the standard may have provided a false sense regarding the level of impact the standard has on insurers. Nuances on how to apply the new guidance were not fully known in 2019; in fact, it is safe to say that the industry was just beginning to scratch the surface on implementation issues. Fast forward to 2023. Today, the lessons and experiences of stakeholders who have progressed on the LDTI journey underscore how complex and challenging this accounting change is, ho operationally extensive it is, and how data-intensive the requirements are.

How familiar are analysts and rating agencies with LDTI?



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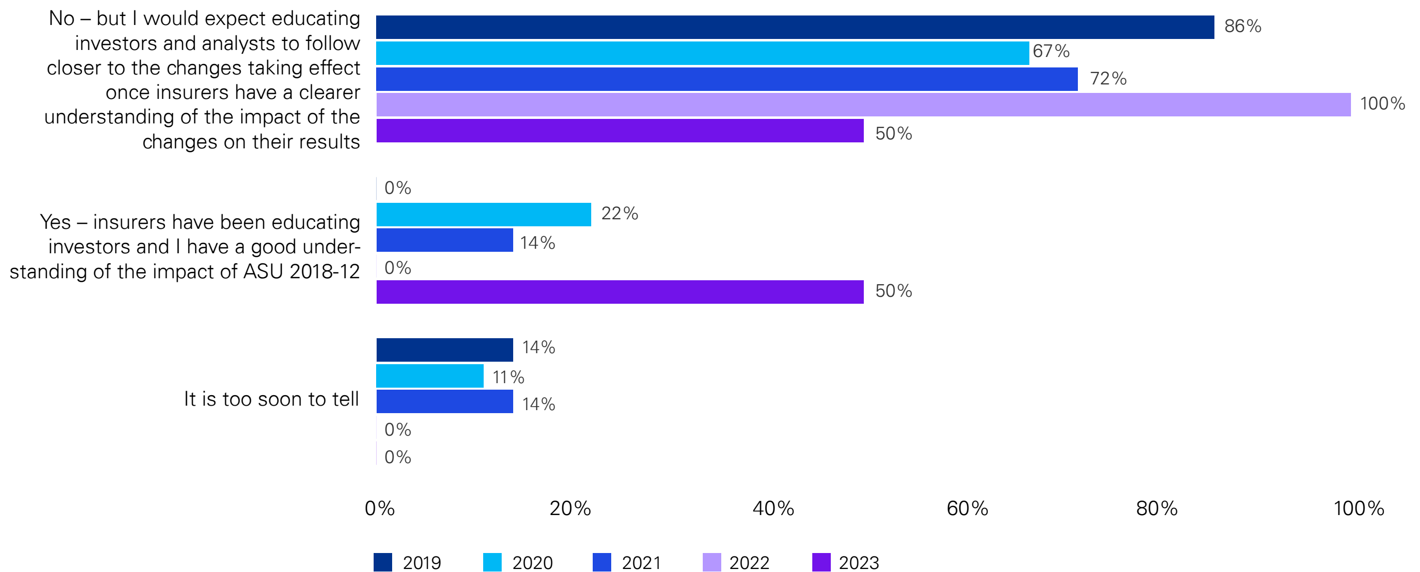
What is the progress on LDTI education?

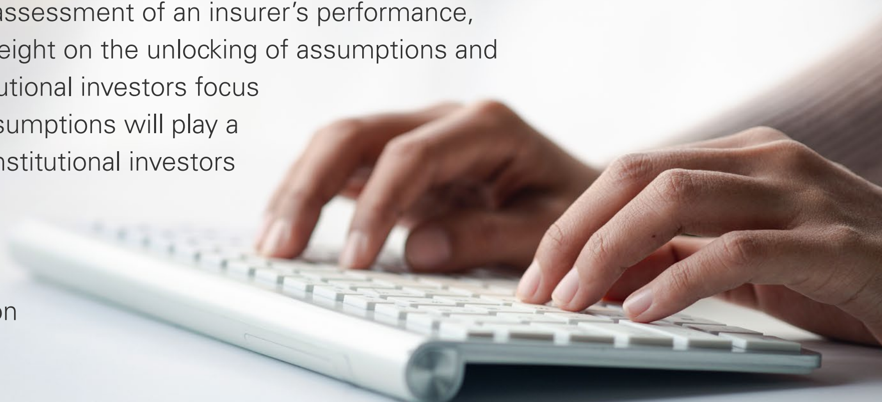
Currently, half of analysts surveyed agree that insurers have done an adequate job in educating investors and analysts on the impact of LDTI. This was not always the case. Even in 2020, only 22 percent of analysts said this was true. However, LDTI education has been gradually increasing each year and we believe that it will only continue to do so, especially once insurers have a more complete understanding of the impacts.

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



Where do institutional investors differ from rating agencies?

While institutional investors and rating agencies share many similar views, it is a helpful exercise to identify areas where they differ in the 2023 survey as compared to the 2022 survey. When asked what LDTI changes will have the most impact on their assessment of an insurer's performance, we discovered that institutional investors place more weight on the unlocking of assumptions and enhanced disclosures. We believe this is because institutional investors focus more on earnings volatility in which the unlocking of assumptions will play a key role. Moreover, enhanced disclosures will provide institutional investors additional information to assess the overall financial health of an insurer when faced with greater earnings volatility. To offset volatility, a simplified DAC model which results in an approximate straight-line amortization will help smooth earnings.



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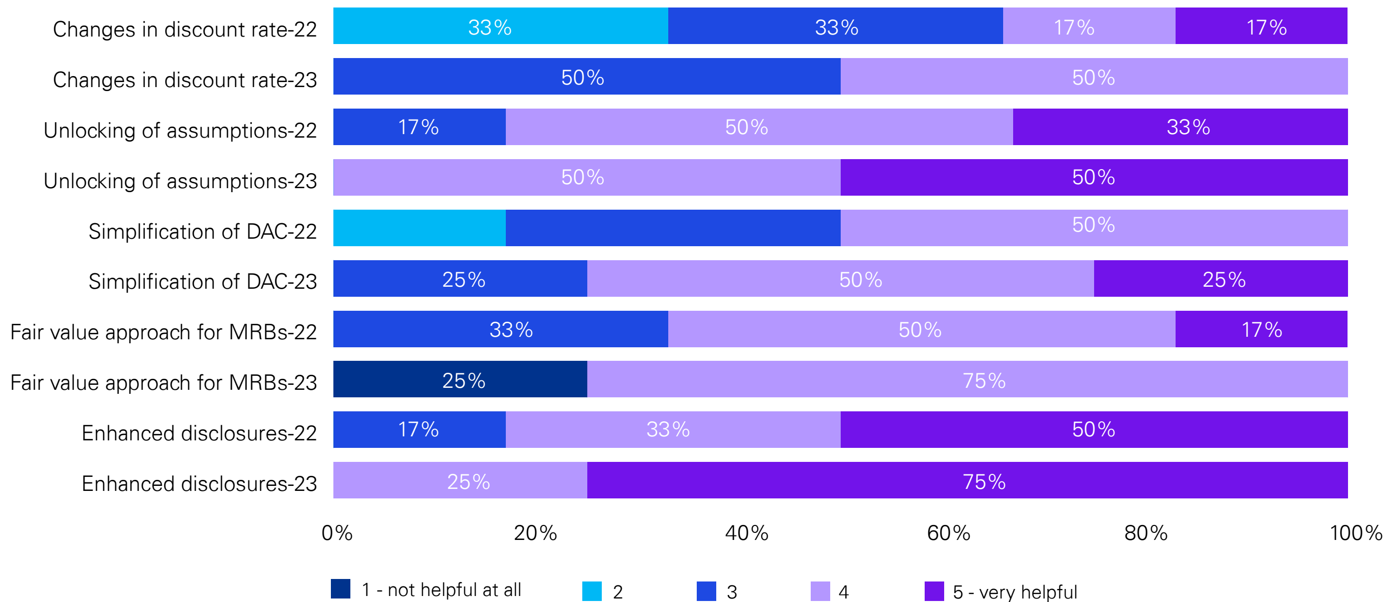
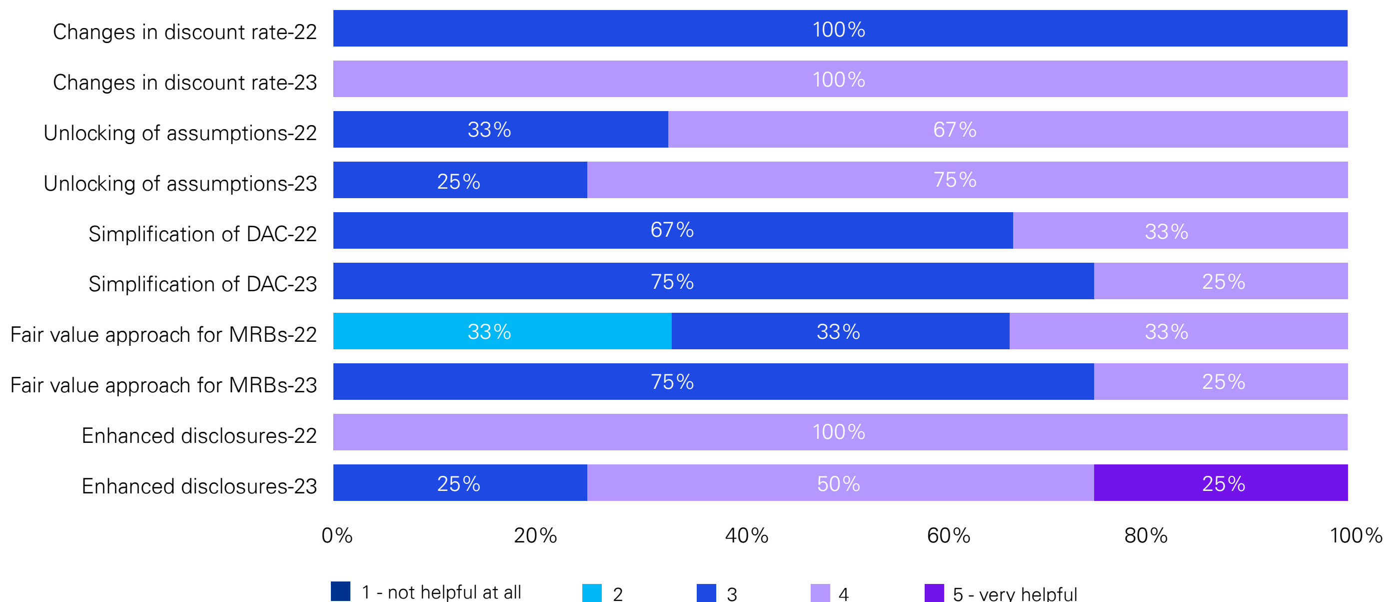
How do institutional investors view the changes arising from ASU 2018-12 as it relates to their assessment of an insurer's financial performance?



Rating agencies, on the other hand, place less significance on any one change with fewer 5-ratings given and a larger proportion of 3 and 4 ratings across the board. This signals that LDTI will have less of an impact on their overall analysis, but all items are given mostly equal weight. In 2023, half of the rating agency respondents said they would not change either the approaches to their valuation models or their inputs. On the other hand, half of the institutional investor respondents said they would change their approaches and inputs to their models. No rating agencies said they would change the approaches to their models.

How do 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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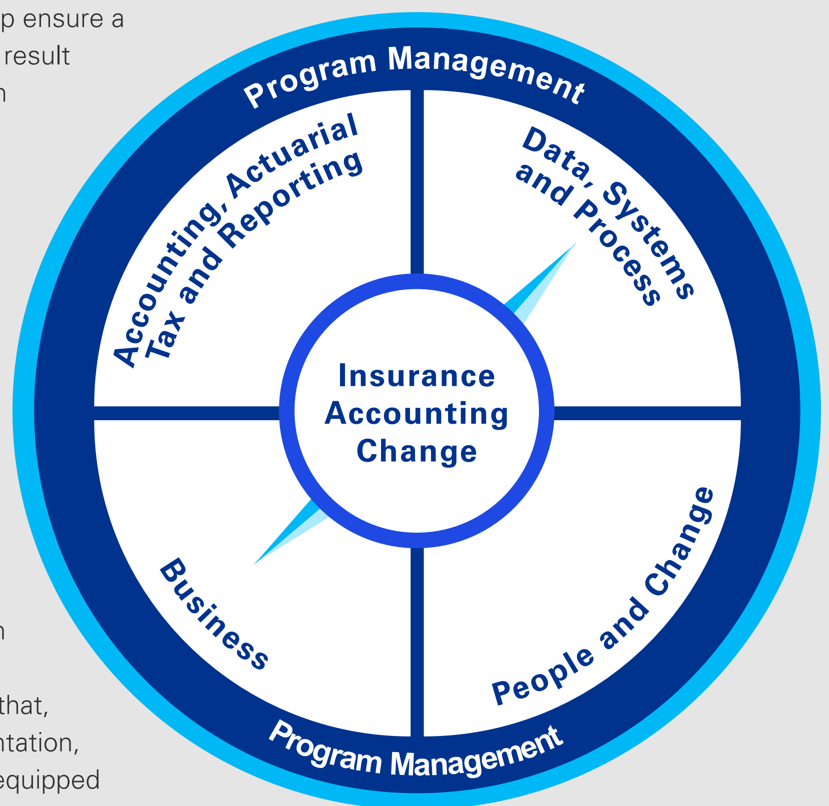
How KPMG can help

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 experts ready to provide your company with a suite of services needed to thoroughly 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 areas of expertise are individually important to 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 gained from advising 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, 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 expertise to deliver 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 will be fully equipped to maintain processes and be able to account and report in a manner that is in full compliance with regulations and provides maximum 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 firm's tailored methodology that considers the impact of LDTI for your business in a structured way. This structure will provide insight in a manner that is tailored specifically to your business and strategic objectives.

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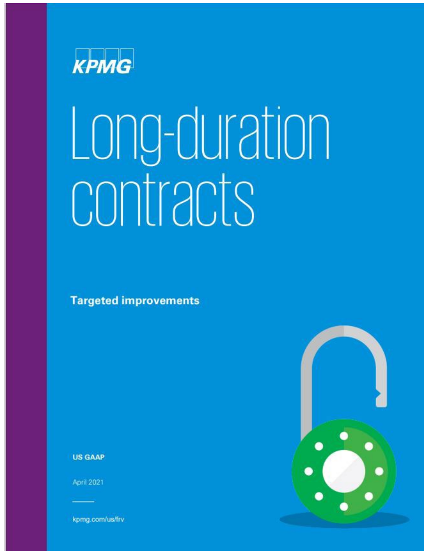
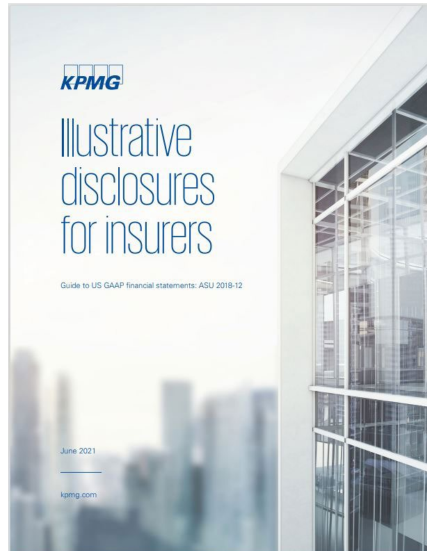
Related thought leadership

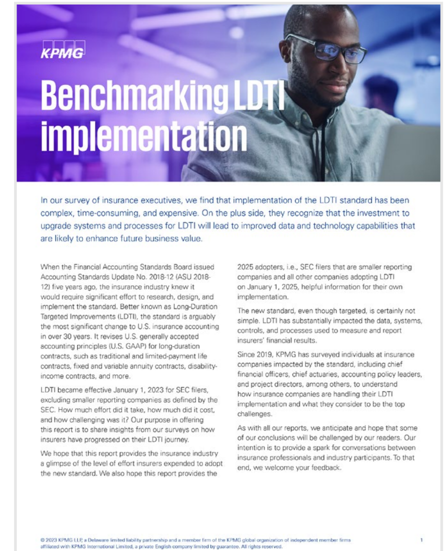
Find these and more on the "KPMG Insurance Accounting Change Hub"



Handbook: Long-duration contracts (kpmg.us)



Illustrative disclosures for insurers adopting ASU 2018-12 (kpmg.us)



KPMG

Benchmarking LDTI implementation

In our survey of insurance executives, we find that implementation of the LDTI standard has been complex, time-consuming, and expensive. On the plus side, they recognize that the investment to upgrade systems and processes for LDTI will lead to improved data and technology capabilities that are likely to enhance future business value.

When the Financial Accounting Standards Board issued Accounting Standards Update No. 2018-12 (ASU 2018-12) five years ago, the insurance industry knew it would require significant effort to research, design, and implement the standard. Better known as Long-Duration Targeted Improvements (LDTI), the standard is arguably the most significant change to U.S. insurance accounting in over 30 years. It revises U.S. generally accepted accounting principles (U.S. GAAP) for long-duration contracts, such as traditional and limited-payment life contracts, fixed and variable annuity contracts, disability-income contracts, and more.

LDTI became effective January 1, 2023 for SEC filers, excluding smaller reporting companies as defined by the SEC. How much effort did it take, how much did it cost, and how challenging was it? Our purpose in offering this report is to share insights from our surveys on how insurers have progressed on their LDTI journey.

We hope that this report provides the insurance industry a glimpse of the level of effort insurers expended to adopt the new standard. We also hope this report provides the 2025 adopters, i.e., SEC filers that are smaller reporting companies and all other companies adopting LDTI on January 1, 2025, helpful information for their own implementation.

The new standard, even though targeted, is certainly not simple. LDTI has substantially impacted the data, systems, controls, and processes used to measure and report insurers' financial results.

Since 2019, KPMG has surveyed individuals at insurance companies impacted by the standard, including chief financial officers, chief actuaries, accounting policy leaders, and project directors, among others, to understand how insurance companies are handling their LDTI implementation and what they consider to be the top challenges.

As with all our reports, we anticipate and hope that some of our conclusions will be challenged by our readers. Our intention is to provide a spark for conversations between insurance professionals and industry participants. To that end, we welcome your feedback.

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Benchmarking LDTI implementation

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