

Practical Considerations for Implementing FASB Long Duration Targeted Improvements

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Agenda

1. Review of Requirements for Individual Life Contracts
2. Deferred Acquisition Cost
3. Policy Benefit Liability (PBL)
4. PBL Roll Forward Requirements

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LDTI Requirements

Key Elements of Change Under LDTI

Whole Life and Term Contracts

Deferred Acquisition Cost		
<ul style="list-style-type: none">• Constant basis amortization• Amortization should be independent of revenue or profit• Assumptions should be consistent with liability• Does not accrue interest• Only current period deferrals• Excess terminations result in write down of DAC• Calculated seriatim or grouped		

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Key Elements of Change Under LDTI

Whole Life and Term Contracts

Deferred Acquisition Cost	Policy Benefit Liability	Expanded Disclosures
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Deferred Acquisition Cost

Deferred Acquisition Cost

Key Considerations

$$DAC_t = DAC_{t-1} + \text{Deferrals} - \text{Amortization} - \text{Experience Adjustment}$$

Deferred Acquisition Cost

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$$DAC_t = \mathbf{DAC}_{t-1} + \text{Deferrals} - \text{Amortization} - \text{Experience Adjustment}$$

- » Previous period DAC is an input into current period's calculation
 - Need an efficient way to capture DAC and make it part of historical record

Deferred Acquisition Cost

Key Considerations

$$DAC_t = DAC_{t-1} + \text{Deferrals} - \text{Amortization} - \text{Experience Adjustment}$$

- » Deferrable costs are from current period only
- » Will process of obtaining deferrals be same under LDTI?
- » Either driven by per unit assumptions or will use direct historical input
- » How to allocate costs to each cohort?

Deferred Acquisition Cost

Key Considerations

$$DAC_t = DAC_{t-1} + \text{Deferrals} - \text{Amortization} - \text{Experience Adjustment}$$

- » What is the most appropriate amortization basis?
 - Inforce face? Number of contracts?
- » Projection of amortization basis must use assumptions consistent with those used for policy benefit liability
- » Which set of assumptions – current or prior?

Deferred Acquisition Cost

Key Considerations

$$DAC_t = DAC_{t-1} + \text{Deferrals} - \text{Amortization} - \text{Experience Adjustment}$$

- » Intended to quantify effect of excess terminations
- » One-sided adjustment
- » Is it reasonable to embed effect of actual experience in amortization factor?

Deferred Acquisition Cost

Key Considerations

$$DAC_t = DAC_{t-1} + \text{Deferrals} - \text{Amortization} - \text{Experience Adjustment}$$

» Seriatim or grouped?

- Detailed analysis may lend itself to a seriatim approach
- Some believe that seriatim approach results in faster amortization

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Policy Benefit Liability

Policy Benefit Liability

Key Considerations

$$\text{PBL} = \text{PV Benefits} - K * \text{PV Gross Premiums}$$

$$K = (\text{Accum Benefits} + \text{PV Benefits} - \text{Accum Transition Balance}) / (\text{Accum Gross Prem} + \text{PV Gross Premium})$$

- » Assumptions updated annually
- » May need to develop additional controls and processes around experience studies and assumption updates

Policy Benefit Liability

Key Considerations

$$\text{PBL} = \text{PV Benefits} - K * \text{PV Gross Premiums}$$

$$K = (\text{Accum Benefits} + \text{PV Benefits} - \text{Accum Transition Balance}) / (\text{Accum Gross Prem} + \text{PV Gross Premium})$$

- » Actual experience is an input to the net premium ratio calculation
- » How do you define the “actuals”?
- » What additional controls are needed?
- » How frequently should unlocking occur?

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PBL Roll Forward Requirements

Policy Benefit Liability

Roll Forward Example

Balance, beginning of year	XXX
Beginning balance at original discount rate	XXX
Effect of changes in cash flow assumptions	XXX
Effect of actual variances from expected experience	<u>XXX</u>
Adjusted beginning of year balance	XXX
Actual cash flows	XXX
Interest accrued	<u>XXX</u>
Ending balance at original discount rate	XXX

Policy Benefit Liability

Roll Forward Example

Balance, beginning of year	XXX
Beginning balance at original discount rate	XXX
Effect of changes in cash flow assumptions	XXX
Effect of actual variances from expected experience	<u>XXX</u>
Adjusted beginning of year balance	XXX
Actual cash flows	XXX
Interest accrued	<u>XXX</u>
Ending balance at original discount rate	XXX

Policy Benefit Liability

Alternative Roll Forward Example

	Effect of changes in mortality assumption	XXX
(+)	Effect of changes in lapse assumption	<u>XXX</u>
	Effect of changes in cash flow assumptions	XXX
	Effect of actual claim variance from expected	XXX
(+)	Effect of actual premium variance from expected	<u>XXX</u>
	Effect of actual variance from expected experience	XXX

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