

SVL2/PBA

Donna Claire, Chair

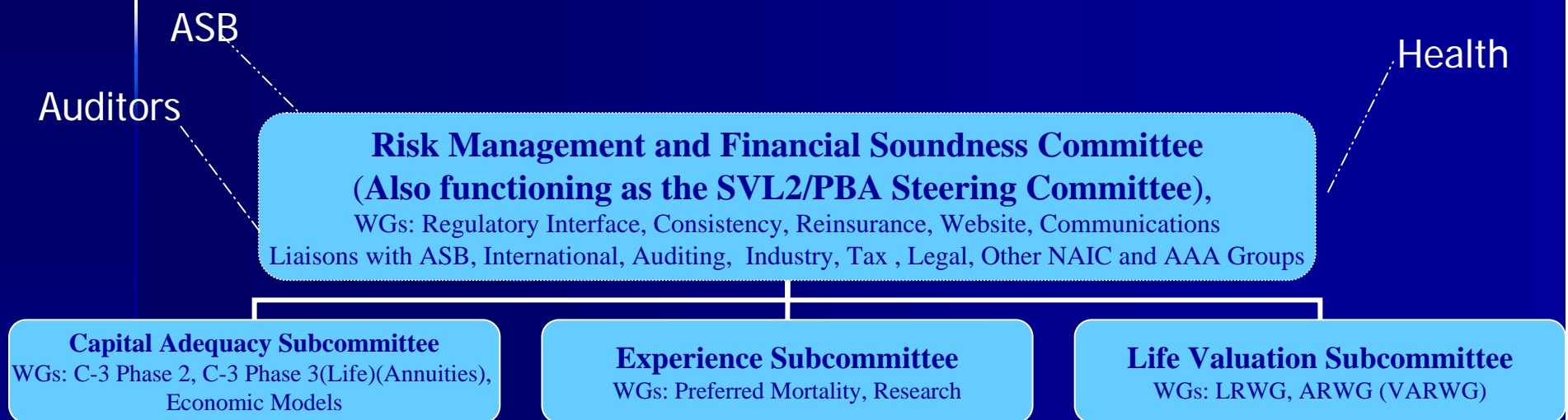
Risk Management and Financial Soundness Committee
Presentation to LHATF March 2, 2006



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American Academy of Actuaries
Risk Management and Financial Soundness
Committee
March 2006 1

Structure



Note: WGs = Work Groups



SVL2/PBA Steering Committee

- Chair: Donna Claire
- Sets overall direction of principles-based reserves and capital
- Coordinates SVL2/PBA activities
- Monitors progress
- Weekly calls



Communications/ Webcasts

- Goal is to keep everyone up to date on all PBA activities
- First given January 12, 2006
 - Over 300 called in
 - Slides and audio are available on Academy website www.actuary.org



Next Webcast

- March 22, 2006 from noon to 1:30pm EST
- Free for regulators and work group members
- Register at www.actuary.org



Website WG

- Chaired by Shawn Loftus
- Provides update for all PBA projects, with links to more detailed documents
- www.actuary.org/risk.asp



Reinsurance WG

- Sheldon Summers is chair
- Goal of group will be to make sure reinsurance is considered in all modeling, statutory matters
- Is looking at changes suggested by LRWG, as well as reviewing other reinsurance regulations
- Has bi-weekly calls



Consistency WG

- Bob DiRico is chair
- Covers:
 - Principles of Reserving – updated set
 - Standardized reporting format – to be addressed
 - Definitions – currently working on
- Have periodic calls



RIPGWG WG (Regulatory Interface, Peer Review and Governance)

- Shirley Shao is chair
- Report to follow



Liaisons

- To provide a “go-to” person from various groups
- Also reports back from groups to Academy SVL2/PBA groups



NAIC Liaisons

- LHATF: Mike Boerner and Sheldon Summers
- CADTF: Phil Barlow
- A and E Committees: Barbara Lautzenheiser
- NAIC Statutory Accounting Working Group: Deborah Whitmore



Actuarial Standards Board

- Liaisons: Bob Meilander, Cecil Bykerk
- The ASB has a PBA group chaired by Frank Irish
 - Is expected to bring proposals on PBA to ASB to start project
 - ASOPs require long lead time (i.e. typically at least a year) to get through process



Health WG

- There is a separate Academy committee looking at implications of PBA on health insurance
- Long Term Care is one currently being analyzed



Auditing WG

- Liaison with AICPA: Deborah Whitmore
- AICPA may need to develop additional audit/accounting guidance for auditors
- Accountants/auditing firms (and actuaries associated with audit firms) must follow AICPA/PCAOB professional/independence/scope of services requirements
- Suggest a longer dialogue between LHATF, AAA, Auditing liaison on this at June LHATF



Other Liaisons

- Industry Liaisons: Mike McMahon and Bill Weller
- Tax Group: Dave Sandberg
- Other Academy Committees:
 - Professionalism: Donna Claire
 - Qualification: Donna Claire
 - Financial Reporting: Dave Sandberg
- International: Barbara Lautzenheiser and Dave Sandberg



Life Capital Adequacy Subcommittee

- Nancy Bennett is chair
- Interacts with Philip Barlow's NAIC LCADTF task force
- Does PBA work as well as handling LCADTF questions, such as handling of mod-co dividend liability



LCAS/C-3 Phase 2 WG

- Larry Gorski is Chair
- In January 2006, the Academy released two sets of the pre-packaged scenarios
 - Supplements recommendations for implementing C3 Phase II,
 - Intended to enhance, not replace, the original March 2005 scenarios.
- Academy has audio recording of regulatory Q&A on C-3 Phase 2 from Dec. NAIC meeting on website, www.actuary.org



LCAS: Phase 3 (Life) WG

- Peter Boyko is chair
- Goal is to determine what changes are needed to capital adequacy when changes like those suggested by LRWG are implemented
- Weekly calls



LCAS: Phase 3 (Annuities) WG

- Larry Gorski is chair
- Goal is to work with ARWG to suggest changes to LCAS to go along with a PBA for annuities
- Will need volunteers



LCAS: Economic Models WG

- Larry Gorski is chair
- Is home to economic models (as opposed to slightly different versions for LRWG, capital adequacy, etc.)
- Have periodic calls
- Could use another volunteer



Experience Subcommittee/ Preferred Mortality WG

- Larry Gorski is Chair
- Larry also heads joint SOA/Academy task force
- Separate report given earlier



Experience Subcommittee/ Research WG

- Larry Gorski will be coordinating
- Expect to have a number of projects eventually, e.g.,
 - Lapses
 - Premium persistency



Life Valuation Subcommittee

- Kory Olsen is Chair, Bob DiRico is Vice-chair
- In charge of:
 - LRWG
 - ARWG
 - VARWG
- Also handles other valuation issues/efforts, such as the Life & Health Qualification Manual



Life Valuation Subcommittee /Life Reserve Work Group

- LRWG headed by Dave Neve and Tom Kalmbach
- Separate report on this to be given later



Variable Annuity Work Group

- Tom Campbell is Chair, Jim Lamson is Vice-chair
- Work wrapping up
- Report given earlier



Composition of ARWG

- Chair: Jim Lamson
- Vice Chair: Mike Ward
- Total Membership: 27 regular + 5 interested parties
 - Insurers: 14
 - Consultants / Software / Accounting: 16
 - Regulators / Industry Groups: 2
- Meeting since mid-January



Mission & Plans

- Mission: To develop principles-based reserve requirements for all non-variable annuity products
- Plans: Initial efforts to be applied to development of a single approach applicable to all such annuity products
- Soliciting input and feedback from LHATF!



Payout Annuities & Longevity Insurance

- Gave consideration to limiting initial scope to these products; decided not to
- Resulting piece-wise approach would:
 - Take too long (need to be done before all LHATF members retire!)
 - Strong possibility of inconsistencies between requirements for similar products
 - Insurers change product features to gain benefit of lesser requirements



Build on VARWG & LRWG Work Products

- Can the approach taken in AG VACARVM be modified to be appropriate for other types of products?
- What aspects of the LRWG proposals can be utilized for General Account deferred annuities given the general similarity to Universal Life?



Wide Range of Annuity Designs

- First efforts included developing a (hopefully) exhaustive list of non-variable annuity designs
- Current list has 22 separate types
 - Payout annuities
 - Traditional deferred annuities with interest credits
 - Equity Indexed Annuities
 - Many more ...



Principles-Based Approach (PBA) Review

*Regulatory Issues, Governance and
PBA Review Work Group*



PBA Review Is Needed

- Review the “subjectivity” in PBA valuations
- Promote commonly accepted practices
- Promote consistency among companies
- Supplement and facilitate state exams
- Complement review between state exams
- Allow review on a pre-release basis
- Provide comfort to regulators, management and other users



Sample Structure

- PBA Review:
 - Permitted by Statute
 - Requirements defined in Regulation/Actuarial Guideline
 - Fleshed out in Actuarial Standards of Practice

Supplemented by State Examination and external audits



Valuation Environment

PBA reviewer is assumed to operate in this environment:

Valuation Actuary:

- Guided by ASOPs, etc. (augmented for PBA)
- Considers all relevant issues
- Provides adequate documentation

External Audit:

- Will focus on auditing

State Examination Process:

- Can (likely) go beyond what valuation actuary does
- Guided by Financial Condition Examiners Handbook
(augmented for PBA)



Principles of PBA Review

- PBA review will evaluate the valuation actuary's work
- PBA review will focus on actuarial judgment (subjectivity) rather than auditing
- PBA review will include processes (e.g., how assumptions are derived from the experience study, modeling construction process)



PBA Reviewer

- PBA reviewer needs to satisfy himself or herself that the valuation was done properly
 - To the extent the valuation actuary's documentation is sufficient, that may be all that needs to be reviewed
 - Where the documentation is insufficient, PBA reviewer will have to go deeper
 - More documentation (product descriptions, studies documentation, etc.)
 - Discuss with contributors (asset cash flows, studies, etc.)
 - To the extent the valuation actuary relies on others, either state exam or external audit may pursue further



PBA Reviewer Sign-off Sample

- I have reviewed the PBA valuation performed by [valuation actuary] and in my opinion:
 - All material risks are captured,
 - the methods used are appropriate* ,
 - the models used are reasonable* for the purpose,
 - the assumptions used are supportable* ,
 - the margins in the reserves are supportable* , and
 - the actuary has followed all relevant laws, regulations, AGs, and ASOPs in doing this work.

* Or other terms to be defined later



Work to Date

- Review of Academy's peer review discussion draft
- Benchmarking
 - Canada: evolving in 2006
 - UK: there is an external review by the auditor
 - Australia: work to get information (may not be any requirements)
 - More work is needed



Work to Date

- Identification and Analyses of key issues:
 - Is PBA Review the same as peer review
 - Conclusion: No
 - Who hires the PBA reviewer?
 - Scope of PBA Review
 - Conclusion: Reflected in sample sign off
 - Who is the audience?
 - Pre-release, post-release or both?



Who Hires the PBA Reviewer

Regulator

- Independence
- Trust of regulator
- Direct Control (dampen independence)
- Costs (via bidding)
- More Reliance in the Exam
- Can have same legal status as Financial Examiners

Company

- Confidence
- Trust of company
- Pre-released Review
- May be less adversarial environment
- Costs (direct payment)
- Familiarity with company risks
- Integration with Company Processes/Management
- Less Burden for regulators



Next Steps

- Continue work to flesh out concept/framework for the PBA Review
- Input to ASB: ASOPS for both valuation actuary and reviewing actuary
- Respond to regulator developments (statute, regulation, examiner's handbook)
- Work with AICPA



Next Steps

Continue work on the concept/framework

- Who can do PBA reviews?
- What are the qualifications for the PBA reviewers?
- What is the PBA review report like?
- Should there be any additional requirements for the PBA valuation actuaries?



Principles-Based Approach (PBA) Governance

*Regulatory Issues, Governance and PBA
Review Work Group*



Work to Date

- Define Scope:
 - Roles and responsibilities of Company Management
 - PBA actuary
 - Appointed Actuary
 - Board
 - Other company management
 - Roles and responsibilities of Regulators
 - Conflict resolution between regulators and company
 - Legal environment
 - Public disclosure
 - What should be in SVL, Reg, AG, ASOP



Work To Date

- Study governance models
 - Basel 2
 - OECD (Organization for Economic Co-operation and Development)
 - IAIS: Insurance core principles
 - IASB
 - Rating Agencies on corporate governance: Moody's, S&P
 - SEC: Principles-based accounting
 - Canada, UK
 - Audit Guidelines



Next Steps

- Develop PBA governance principles
- Flesh out concept/framework for governance
- Input to ASB, if needed
- Respond to regulator developments (statute, regulation, etc.)

