

New Principles-based Valuation Standard for Life Products

LRWG Report to LHATF
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David E. Neve
Co-chair, Academy Life Reserves Work Group



Objectives of this Session

1. Provide an overview of the changes to the proposal since the September LRWG Report.
2. Summarize LRWG Priorities and Timeline for 2006
3. Discuss any comments or questions you have on the proposal
4. Seek LHATF vote to expose proposal for comment
5. Review modeling results of 20-year term product



Form of Proposal

1. Form assumed for this draft:

1. Model Regulation – outlines basic methodologies and principles
2. Actuarial Guideline on setting assumptions – AG PBR
3. Actuarial Guideline on disclosure requirements – AG DIS
4. Actuarial Guideline on margin requirements – AG MAR

2. Presumes changes to SVL have been made, and governance process has been established.



Key Developments in Moving from Discussion Paper to Prototype Model Regulation

1. May need new ASOP for principles-based reserves (PBR):
 - LRWG will work with ASB to develop possible new ASOP(s)
 - Much of what is now in AG PBR may end up in new ASOP(s)
2. Specific assumption margins have been removed from proposal:
 - LHATF will need to decide how margins will be established.
 - AG MAR gives a possible approach to define margin requirements
 - New ASOP could be used to provide guidance in setting margins
 - Could use a combination of prescribed requirements (defined in AG MAR) and actuarial judgment (guidance provided by an ASOP)
 - Pros and cons of alternative approaches will be provided in early 2006



Additions/Changes to Proposal

1. Scope expanded to include all individual life products
2. Mortality assumption:
 - Must use an NAIC approved valuation table that best “maps” to the actuary’s prudent best estimate assumption
 - Presumes a large number (10+) of approved tables are available
 - Credibility method for blending company experience now prescribed
3. Actuary can use company interest rate generator if prescribed calibration standards are met
4. Aggregation of policies allowed for Stochastic Reserve
 - But magnitude of risk offsets limited by Deterministic Reserve
 - Possible method to quantify impact of aggregation is described in AG DIS



Additions/Changes to Proposal

5. Method to determine Earned Rates and Discount Rates defined
 - Path of Earned Rates determined separately for each Asset Segment
 - Earned Rates based on projected net investment earnings, using returns from actual starting assets and modeled reinvestment assets
 - Method to determine new money rates is prescribed
 - Earnings rates reflect appropriate provision for default costs (TBD)
 - Discount rates are set equal to Earned Rates

6. Stochastic Reserve exclusion is permitted for a particular product if actuary can demonstrate Deterministic Reserve is sufficient



Additions/Changes to Proposal

7. Treatment of Non-guaranteed elements

- Can change over time to reflect changing conditions (as in real world)
- Can reflect differences between valuation assumptions and the assumptions underlying the current scale

8. Documentation & disclosure requirements expanded (AG DIS)

9. Other items:

- Aspects related to Separate Accounts
- Treatment of revenue sharing in cash flow model
- Method to allocate Stochastic Reserve to individual policies
- Quantification of aggregate margin from all assumptions
- Modeling of hedges



Items that still need work

1. Treatment of variable products and equity indexed products
2. Methods and/or requirements to determine assumption margins
3. Calibration standards for interest rate scenarios
4. Treatment of non-guaranteed elements (NGE)
5. Documentation requirements for NGE, Reinsurance and Revenue Sharing



Prospective Only versus Inforce

1. Will provide a list of pros and cons of various alternatives in early 2006
2. Possible alternatives:
 - Prospective only
 - Entire Inforce
 - Prospective only, plus AG38 products issued after 7/1/05
 - Prospective only, plus All XXX products issued after the effective date of XXX



LRWG 2006 Priorities

1. Work with LHATF to finalize methodology
2. Work with LHATF to develop methods and/or requirements to establish assumption margins
3. Complete modeling of all major products
4. Work with ASB to develop possible new ASOP(s)
5. Coordinate efforts with C-3 Phase III work group
6. Education and communication efforts
 - Periodic webcasts to provide updates on proposal
 - LRWG Seminar (midyear)
 - Write a new Practice Note on PBR for life products



Recommended Timeline and Deliverables

- LHATF exposes the proposal for comment at the December 1, 2005 LHATF Winter meeting.
- During 2006, LRWG assists LHATF in finalizing the details of the proposal (and assists the C3 Phase III work group to finalize the RBC proposal).
- LHATF approves final draft of reserve proposal at December 2006 LHATF meeting, and sends to A Committee for approval
- Begin state-by-state adoption in 2007.



Open Discussion: Questions or Comments On Proposal

