

PBR Implementation

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NCOIL Summer Meeting
July 11, 2014



PBR Addresses Shortcomings in Current Reserve Methodology

- Current reserve methodology has been fundamentally unchanged for 150 years
- Increased complexity in product design not easily addressed through new regulations or actuarial guidelines
- “One size fits all companies and products” does not work
- Reserves may be too conservative or not adequate for some products and benefits



PBR: 15 Years in the Making

- Different variations of model-based (i.e., principle-based) valuation approaches have been considered over the past 15 years. A PBR framework was first implemented for variable annuities in the mid-2000s.
- The PBR approach contained in the Valuation Manual (VM) is a hybrid between a rule-based and a pure PBR approach
- PBR will be implemented gradually: limited scope and constraints on the methodology (more later)
- PBR is more than valuation: regulators will have more tools and information than ever



PBR: Prescriptive and Limiting Elements

- Concern among regulators exists due to discomfort with a model-based approach and the discretion granted to companies in establishing reserves
- Prescriptive and limiting elements were introduced to address those concerns – transitional guardrails. These guardrails may be temporary or may become permanent.
- Many of these guardrails:
 - May add significant, unnecessary complexity
 - May add excessive conservatism not needed in a fully mature PBR system
 - May cause regulatory requirements to diverge from an insurer's risk management processes



Prescriptive and Limiting Elements to PBR Framework

- PBR only applies to policies issued after the effective date of the manual – not to all inforce policies
- PBR is a dynamic process
 - Assumptions are modified as the economic environment changes (e.g., interest rates, equity returns)
 - Assumptions are modified as other risk factors change (e.g., mortality, policyholder behavior)
 - Note that the current reserve framework utilizes identical assumptions for all insurers that are fixed at the time the policy is issued



Prescriptive and Limiting Elements to PBR Assumptions

- Assumptions are prescribed and/or limited by regulators
- The basis for all assumptions must be fully documented
- PBR assumptions are based on anticipated future experience plus a margin for conservatism
- Adding margins to each assumption will have a cumulative effect, resulting in reserves that may be overly conservative



Prescriptive and Limiting Elements to PBR Assumptions (cont.)

- Reserve assumptions are subject to extensive regulatory oversight requirements
- The SVL requires reporting of claims experience and policyholder behavior experience
- Commissioners have authority to require an insurer to change any assumption or method, and to engage a qualified actuary to review compliance



Prescriptive and Limiting Elements to PBR Results

- PBR includes a minimum reserve based on assumptions set by the NAIC
- Reserves will remain subject to an asset adequacy analysis (a form of stress testing) and an Actuarial Opinion
- PBR implementation is phased in over three years
- An NAIC resource group will work with the states to refine and implement PBR requirements



PBR: A Major Paradigm Shift

- PBR modernizes the valuation techniques for life insurance:
 - from a strictly formulaic basis (static) to requirements that include an insurer's own experience and adjusts with time (dynamic)
 - for products with features customized for the consumer that are difficult to value using the current, inflexible rules
- Insurers are issuing these complex products today



PBR Benefits

- PBR benefits consumers, regulators, and the industry. But, the transition has challenges
- Transitional elements address the challenges:
 - Certain elements (e.g., documentation, reporting of company experience) should be permanent in a PBR framework
 - Certain elements may need to be modified if PBR is to function as intended
- PBR will be subject to continuous review and improvement to assure that it works as intended



Additional Academy Resources

- *Legislation-in-Brief, The Standard Valuation Law and Principle-based Reserves*

http://www.actuary.org/files/PBR_Legislation_in_Brief_8-20-13.pdf

- *PBA Perspectives*, a quarterly update on the principle-based approach

http://www.actuary.org/email/2014/pbr/PBR_6017_2014.html



For More Information

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