PBR Implementation

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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
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
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


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

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