



Definition of “Deficiency” under the GPVAD method for Life Products

American Academy of Actuaries'
Life Reserves Work Group Recommendation to LHATF





Objectives

1. Overview
2. Definition of “Deficiency”
3. LRWG Recommendation





Overview

The APPM Preamble states that Statutory Accounting Principles are:

"conservative in some respects but not unreasonably conservative over the span of economic cycles, or in recognition of the primary statutory responsibility to regulate for financial solvency. SAP attempts to determine at the financial statement date an insurer's ability to satisfy its obligation to its policyholders and creditors."





Overview

International Association of Insurance Supervisors (IAIS) (*Common Structure for the Assessment of Insurer Solvency*) Supporting Principles 8 states:

“The purpose of capital is to ensure that, despite adverse conditions, policy claims and obligations will still be met as they fall due and the required technical provisions* remain covered over a predefined period, to a required level of safety.

* Note: The LRWG interprets “technical provisions” in the above to include statutory reserves.





Overview

Does this mean:

- The objective of reserves is to have an amount on hand to cover future cash obligations until the expiration of the policy?
- The objective of capital is to cover adverse conditions as well as future balance sheet obligations over a specified period of time?





LRWG Recommendation: Definition of Deficiency

- Under the GPVAD method, the deficiency in any year equals:

$$\text{Deficiency} = 0 - \text{Accumulated Assets}$$

- Objective is that the Reported Reserve is sufficient to cover future cash obligations.





Implications of the LRWG Recommendation

1. The GPVAD methodology adequately addresses intermediate cash flow deficiencies.
2. Addresses concerns raised over positive cash flows arising in later years that offset cash flow deficiencies arising in earlier years.
3. Results in the reserve equal to the maximum Gross Premium Reserves.
4. Results in a consistent method for all life products whether or not they have cash values.

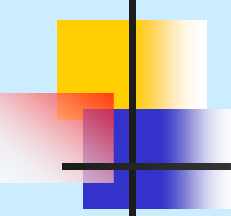




Implications Continued

5. No “working reserve” is needed
6. Purpose of reserves is to adequately cover future cash obligations.
7. Recommendation is consistent with APPM Preamble.





Rationale against a Working Reserve equal to the Cash Value

1. LRWG has concluded the purpose of reserves is to adequately cover future cash obligations.
2. The CTE reserve approach, with prudent best estimate assumptions, provides adequate conservatism in the methodology.
3. For a company issuing policies, such as whole life policies, where the reserve is typically equal to the cash value, reserves can increase above current levels due solely to a cash value working reserve when a portion of invested assets are equities.
4. The reserve methodology is consistent across product types whether these products have cash values or not.

