

Proposed PBA Review

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Objectives of the PBA Review

- Provide assurance regarding the PBA valuation:
 - Validate actuarial judgment
 - Confirm compliance
 - Reinforce valuation process
- Promote consistency across companies
- Provide information for state financial analysis in between exams
- Facilitate state exam and audit work



Scope of PBA Review

Evaluate the judgment used by the valuation actuary rather than audit if calculation is done correctly

- What's covered
- What's not covered
- Levels of review



Filing Requirements

- PBA review opinion to all licensed states
- Confidential for Regulators, Company and auditor though can still be subpoenaed.
- File by later of 3/31 or 30 days following annual statement
- Domiciliary state may grant an extension



Who Hires

- Company's Board of Directors will hire and discharge the PBA Reviewer
- Domiciliary state is notified of the hiring no less than 6 months before the PBA review is filed.
- Acceptance letter from the PBA reviewer needs to be attached to the notice to regulators.
- Domiciliary state may veto with cause within 30 days of this notice.



Who Does the PBA Review

- Work Group recommends external, independent reviewers
 - Consulting actuary; or
 - Auditing actuary (performs an audit for the same client).
- LHATF is still reviewing whether auditing actuaries should be allowed to perform PBA review.



Qualification of PBA Reviewer

- Same professional qualifications as the appointed actuary.
- Qualification for appointed actuary/qualified actuary is being reviewed



Independence

- General:
 - Cannot be company management
 - Cannot participate in the work he/she is reviewing; or
 - Cannot serve in an advocacy role for the company.
- Domiciliary state may waive requirements



Independence

■ Specific rules

- Shall not have been a company employee three years prior;
- Shall not be an employee of the same firm that is hired as the appointed actuary;
- Shall not have any material financial interests;
- Shall not perform PBA review for more than 5 consecutive years (can come back after 5 years);
- Shall not have conflict of interest



PBA Review Products

- Opinion: submitted to all licensed states
- Report: available upon request to regulator
- Other documentation (such as work papers): available to regulator upon request

All shall be kept confidential.



PBA Review Opinion

Prescribed recommended language:

- Identification and Qualification
- Scope
- Reliance
- Opinion
- Special circumstances
- Table of reserves



PBA Review Opinion

Opinion Language

- All quantifiable material risks are considered.
- The methods used are appropriate.
- The models used are reasonable for the purpose.
- The assumptions used are supportable.
- The margins used are supportable.
- The domiciliary requirements and relevant ASOPs have been satisfied.



PBA Review Opinion

- Reliance on
 - Company management
 - Other PBA reviewers
- Adverse opinion
- Early warning requirements



PBA Review Report

Supports PBA review opinion

- Describe the extent of work done.
- Discuss how the reviewer reached his/her conclusions.
- Disclose findings, concerns, recommendations.
- Assess compliance.
- Assess quality and sufficiency of PBA valuation report.
- Describe any remaining differences.



PBA Review Report

- Formal report with required content
- Prepared by the PBA reviewer
- Received by the Board
- Confidential (regulators, company and auditor)
- Available to regulator upon request
- 7 year retention rule



PBA Review Documentation

- Documentation may include: Planning material, work plans, analyses, memoranda, letters, schedules and documentation from the company, etc.
- Confidential and available to regulators upon request
- 7 year retention rule



Confidentiality

- As prescribed by the AOMR for Actuarial Memorandum
- Reasons for keeping PBA review opinion confidential
 - Appointed actuary provides “the” opinion
 - PBA reviewer opines on a subset of valuation
 - 3/31 deadline makes public disclosure difficult
 - Legal exposure of public opinion limits pool of reviewers and significantly increases costs
 - Consistent with Canada and Australia



PBA Reviewer and Company

- Similar to independent auditor relationship
- Board
 - Appoints and discharges the PBA reviewer
 - Ongoing dialogue with the PBA reviewer
 - Receives the PBA review opinion and PBA review report
- Conflict resolution:
 - Board may be involved if any material conflict between valuation actuary and PBA reviewer
 - If Board/Company supports the valuation actuary, PBA reviewer can issue a “qualified” opinion
 - State will resolve it ultimately



Valuation Actuary and PBA Reviewer

- Collegial and cooperative peer relationship
- Work process:
 - Most work between the two is done pre-release
 - Earlier drafts will be shared pre-release
- Conflict resolution:
 - Resolve issues along the way
 - In rare situation when two disagree, PBA reviewer can
 - Inform senior management and Board (if company hires) and then the state
 - Report to the state (if state hires)



How PBA Reserve Fits with Current Framework

- **Is PBA reserve the minimum or adequate reserve?**
 - It is the minimum reserve; can't offset formula reserves
- **Should PBA perform Asset Adequacy Analysis?**
 - Yes, but testing method is up to the appointed actuary.
 - Adequacy in PBA reserve can offset deficiency in non-PBA reserve.



Changes to the Current Valuation Framework

- No change to the AOMR
- ASOP 22 needs to be reviewed to see if certain PBA valuation can be included as an acceptable AAT method



Single Opinion and Multiple Certificates

- **Single Actuarial Opinion:**
 - For the entire company
 - Covers both PBA and non-PBA
 - Appointed Actuary is responsible
- **Multiple Certificates:**
 - Appointed Actuary may rely on PBA certificates (like other reliance statements)
 - PBA certificates don't stand alone



Regulatory Use of PBA Review

- Use as a financial oversight tool on an annual basis.
- Uniform oversight is desirable.
- Education may be needed.



Benchmark

- Canada and Australia (P&C only)
- Similar to the above U.S. proposed framework except:
 - Regulators cannot veto company's choice of a PBA Reviewer
 - Covers reserves, capital, dynamic financial conditions, equity treatment of policyholders, etc.
 - Canada: every 3 years to cover all of the above
 - Australia: also includes controls
- Both allow auditing actuary to perform PBA Review



New PBA Environment

- **Valuation Actuary:** will perform PBA valuation and follow related requirements
 - **PBA Reviewer:** Will cover actuarial judgment and most work is pre-release with a post release deadline of 3/31 or 30 days following annual statement
 - **External Auditor:** Continues traditional audit responsibilities which consider actuarial judgment and other aspects of auditing; post –release (6/1)
 - **State Examination Process:**
 - Will continue to be guided by Financial Conditions Examiners Handbook (which needs to be augmented for PBA)
 - **Company:**
 - Board: Will be more involved in PBA (e.g., appoint PBA actuary, receives reports and possibly review conflicts and hire PBA reviewer), especially if company hires the PBA reviewer)
 - Other management: Will be more involved (feedback loop, etc.)
- Feedback Process: regulators, companies, reviewers, ASB, AAA etc.



Changes Needed

- Standard Valuation Law: reference to a PBA review
- PBA Review Regulation: new regulation
- Actuarial Standards of Practices: new ASOPs for some elements of the PBA Review



Critical Decisions

- Can auditor also be the PBA Reviewer?
- Should there be a single or multiple PBA review opinion(s)
- How to achieve uniformity?
 - State adoption of the PBA review regulation
 - Ongoing state oversight
- Application to reserves and capital?



Auditor as PBA Reviewer

- Meets current independence criteria for auditors
- Board's decision to hire
- An element of efficiency and savings
- Similar issue for consulting actuaries
- Increases the pool of qualified actuaries



Single versus Multiple PBA Review Opinion(s)

Single PBA Review

- Completeness: covers all PBA valuation (nothing fell thru)
- One contact point: for the Board, regulators and auditor
- Consistency (approaches, assumptions, etc.)
- May rely on other PBA reviewers
- Parallel to AOMR structure

Multiple PBA Reviews

- May hire different reviewers for different expertise



Uniformity

- Uniform state adoption: PBA review regulation should be included in the valuation law manual
- Uniform state oversight:
 - Consistent review



Application to PBA Capital

- Work Group recommends applying the PBA Review to PBA capital
- Similar to PBA reserves
 - Has actuarial judgment elements
 - Requires similar valuation framework
- Not so similar
 - RBC instruction manual rather than SVL
 - No appointed actuarial opinion



Status

- Submit PBA review white paper by September NAIC meeting
- Submit a PBA Review Regulation for September NAIC meeting
- Propose to expose the PBA Review Regulation for comments
- Inform ASB of the need for a new ASOP and a review of two existing ASOPs
- Propose to extend the PBA Review to PBA capital by 1Q, 2007

