

PBR—What it is and Where We Are

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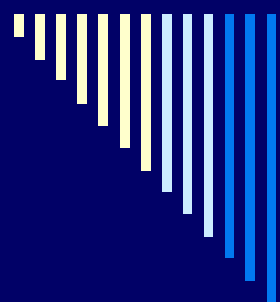
Introduction

- PBR introduced at Dec. 2005 NAIC
 - Scope expanded to include all lines
 - Current life reserves formulaic
 - Original PBR very free form, realistic assumptions, stochastic
 - Opposition in 2006: onerous, useful?
 - Creation of Subgroup 4: Continuing Requirements / Transition Subgroup of VLMT
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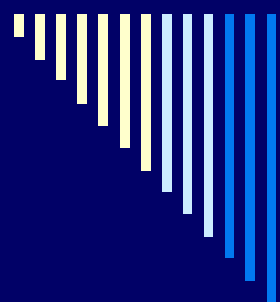
Purpose (VM-20 Life)

- A—Define minimum valuation standard for individual life by PBR as defined in the Valuation Manual
 - B Method of calculating reserves defined herein IS CRVM
 - C Reserve for supp benefits / riders must be consistent
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Guiding Principles - 1

- 1 - Prospective valuation method that captures material risks of policies/assets
- 2 - Must reflect all risk factors explicitly /implicitly included
- 3 – Deterministic approach may be sufficient but stochastic may be necessary
- 4 – If company has some control over risk (e.g. mortality), must blend experience with prescribed assumptions credibly



Guiding Principles - 2

- 5 – If assumption is not stochastically modeled, include margins for uncertainty
- 6 – Assumptions not determined at issue but updated
- 7 – Long statement about limitations of models and compensatory use of assumptions and risk management



Some Key Features - 1

- Relation of when deterministic and when stochastic to be used still being worked on
 - Independent PBR review Actuary position created
 - Procedures for setting mortality, policyholder behavior (e.g. lapse, etc.), expense, assets, reinsurance and revenue-sharing assumptions described in separate sections
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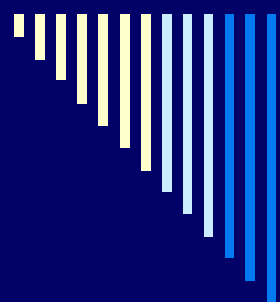
Some Key Features - 2

- ❑ Must submit experience for mortality, policyholder behavior, assets and expenses, sent to a central authority
 - ❑ An extensive report
 - ❑ One goal: allow detailed professional standards to be updated; thus a lot is in the Valuation manual
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Role of Subgroup 4

- ❑ Project of AAA (American Academy of Actuaries)
 - ❑ Working groups (Life, Annuity, Health)
 - ❑ Life Valuation Law and Manual Team (VLMT)
 - ❑ Subgroup 4: Continuing Requirements / Transition
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Smaller Company Concerns

- ❑ Key products are XXX term, UL with 2ndary guarantees, variable
- ❑ Smaller companies tend not to write these
- ❑ Often small face life, credit, health
- ❑ Large number of small companies; lot of work for regulators
- ❑ Smaller tend to have larger surplus



Possible Exemptions Thresholds 2005 Data

Total Asset Threshold	Number of Companies	Ratio of C&S to TA	Mean General Expenses	Median General Expenses	Mean Net Income	Median Net Income
< \$20 million	322	57%	683,000	160,000	176,000	91,000
< \$40 million	410	49%	1,007,000	242,000	309,000	140,000
< \$100 million	518	42%	2,086,000	412,000	556,000	211,000
< \$500 million	700	27%	5,087,000	936,000	1,736,000	351,000
Total Industry	1,022	7%	46,119,000	3,655,000	39,576,000	974,000



Subgroup 4 March Report

- 1 – Process to justify exclusion from stochastic too complex; expensive; unnecessary
 - 2 – Cost of independent review actuary
 - 3 – Experience reporting perceived as unnecessary for companies with no credible experience
 - 4 – Cost may put small companies at a disadvantage
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Stochastic modeling

- ❑ Major accomplishment to recognize that stochastic not always best
 - ❑ Exemption test requires 12 scenarios
 - ❑ Must be done within 12 months of valuation
 - ❑ Process being worked out
 - ❑ Divide maximum difference by an anticipated economic scenario
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Independent Review Actuary

- Initially, struggle over whether state appointed or company appointed
 - Final AAA: Company appointed but state can veto
 - Cannot be from same firm as ValActuary
 - LHATF SURPRISE: This position was deleted by a heavy vote
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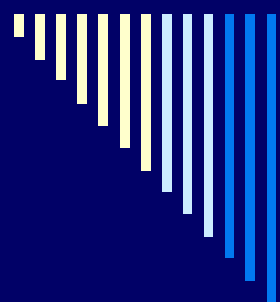
Significance

- ❑ Was a long-standing struggle over who would choose independent actuary
 - ❑ Regulators wanted to do so
 - ❑ Industry: was part of Valuation Actuary function
 - ❑ Current AOMR allows regulators to hire an actuary at Comp. expense to check work (rarely used)
 - ❑ Small Co. Impact: cost of Ind. Acty. Eliminated; states not likely to extend hiring for traditional business
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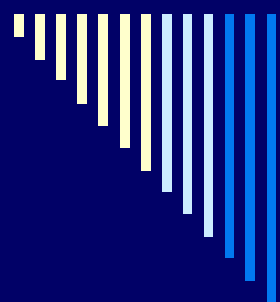
Experience Reporting

- ❑ Simplified procedure, not exemption
 - ❑ Mortality: as yet unspecified premium volume
 - ❑ Other assumptions: as yet unspecified
 - ❑ Different Lines of business
 - ❑ See Subgroup 3 survey in Nov. “small talk” on experience exclusions (pp. 23-25)
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Time Frame

- ❑ Not exposed at LHATF meeting prior to NAIC
- ❑ Will be voted on in a separate phone call later in Dec.
- ❑ Voted on in 2008 (March?, June?)



Workload Problem

- Some regulators concerned about workload if implemented all at once
- Subgroup 4 sent out a survey on preferences for phased introduction (See “small talk”, Nov. 2007, pp. 26 et seq.)
- Phase in not mentioned in PBR documents for Winter NAIC meeting (LHATF will consider 3-5 year phase in)



Other LHATF Activity

- ❑ LHATF commissioned AAA to come up with PBR
 - ❑ Now LHATF has taken control of LRWG product (not ARWG or HRWG yet)
 - ❑ Reserves must be calculated no more than 3 months prior, not 6 months (AAA)
 - ❑ Not content with stochastic exclusion
 - ❑ Want catastrophic events considered
 - ❑ Considering many other changes
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Summary

- ❑ Certain products benefit from regulation: XXX term, 2ndary guar. UL, variable
 - ❑ Smaller companies with traditional products will not benefit
 - ❑ In Canada after PPM introduced in 1992 smaller companies faded away
 - ❑ All inclusiveness a problem
 - ❑ No one has estimated what the typical cost might be
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