



Adopted by the Principle-Based Reserving Implementation (EX) Task Force – 4/10/17

## Principle-Based Reserving (PBR) Implementation Plan

### Introduction

This Principle-Based Reserving (PBR) Implementation Plan outlines regulatory and NAIC actions needed to successfully implement PBR. It provides a framework for implementation and will be a working document to be modified as decisions are made, questions are raised, and deliverables are met. The Principle-Based Reserving Implementation (EX) Task Force will complete activities included in this plan or propose charges to other NAIC groups. The *Valuation Manual* became effective Jan. 1, 2017. There is a three-year transition period, starting Jan. 1, 2017, during which companies can choose to move some or all applicable new business to PBR. Beginning Jan. 1, 2020, compliance with PBR is mandatory for all companies not otherwise exempted.

The following work is continuing in 2017:

### **I. Enhance the PBR Methodology and Update the *Valuation Manual***

- A. The Life Actuarial (A) Task Force continues to discuss proposals to improve the PBR methodology and the *Valuation Manual*. The Executive (EX) Committee and Plenary last adopted changes to the *Valuation Manual* on Aug. 29, 2016.
- B. NAIC staff is updating the asset spread PBR data tables on a quarterly basis and the default cost PBR data tables on an annual basis. There has been discussion on changing the current spread determination from quarterly to monthly, as well as changing the methodology from a quarterly average of spreads to a date-specific point in time. The goal of the change is to have current spreads updated and available for use at each month-end, which means the current spread determination date will have to be moved in advance of each month-end.

### **II. Create a Reporting and Regulatory Review Process**

- A. A PBR Pilot Project has been completed, with 11 companies participating. The pilot was useful in educating and training regulators, honing review procedures and identifying needs to clarify sections of the *Valuation Manual*. Benefits for companies included testing their systems and interacting with regulators in completing the confidential PBR actuarial report. As part of the project, the states and the NAIC entered into confidentiality agreements. The final pilot project report was made available in March and will be discussed at the Spring National Meeting.
- B. The PBR Review (EX) Working Group is responsible for coordinating the development of financial analysis, examination and actuarial review procedures, in addition to evaluating NAIC and state insurance department actuarial staff resource requirements.
- C. The PBR Blanks (EX) Subgroup has completed annual financial statement PBR blanks and instruction changes and created a VM-20 Reserve Supplement. The PBR Review Procedures (EX) Subgroup has taken the following action: 1) drafted changes to the *Financial Analysis Handbook*; 2) drafted changes to the *Financial Condition Examiners Handbook*; 3) created a data collection template for reporting of company modeling and modeling assumptions; and 4) started developing new regulatory tools.

- D. Peer and quality reviews of PBR will be conducted by the new Valuation Analysis (E) Working Group, whose membership has been constituted. This Working Group will operate in a manner similar to the Financial Analysis (E) Working Group, working collaboratively with state insurance regulators, responding to issues and questions, and recommending PBR requirements and interpretations. Valuation Analysis (E) Working Group membership comprises regulators with actuarial, financial examination and financial analysis experience. Revised charges for the Valuation Analysis (E) Working Group will be considered by the Financial Condition (E) Committee at the Spring National Meeting.
- E. To assist the states in reviewing company PBR reserve calculations, the NAIC has purchased a modeling software package and is hiring two additional actuaries. NAIC staff will be asked to assist regulators with the following support:
  - 1) Provide support and/or analysis to states in reviewing specific companies' PBR models.
  - 2) Update procedures in the *Financial Condition Examiners Handbook* and the *Financial Analysis Handbook* to promote consistent PBR review.
  - 3) Provide PBR analysis and respond to questions from the states on companies to be examined or during the course of an examination.
  - 4) Provide analysis and recommend answers or improvements regarding PBR and asset adequacy analysis to support states, the Life Actuarial (A) Task Force and the Valuation Analysis (E) Working Group.
  - 5) Through ongoing communication with regulators, the industry and interested parties, NAIC staff will facilitate the refinement, revision, development and implementation of PBR reserve requirements and review of models, as necessary. For example, the process will address the need to adjust margins, as appropriate, to maintain conservatism, to recognize improvements in modeling techniques and/or to affect changes in assumptions due to emerging experience.
  - 6) The Society of Actuaries (SOA), in addition to regulatory and industry actuaries, has developed PBR surveys to estimate workload for the initial year of PBR and help identify resource requirements for the NAIC and regulatory actuaries.

### **III. Create the Company Experience Reporting Framework**

- A. The Principle-Based Reserving Implementation (EX) Task Force has created an experience reporting framework, including procedures and timing for collection, cost control, dissemination of data and funding.
  - 1) Initial data to be collected and the associated reporting structure are defined in the *Valuation Manual* in VM-50, Experience Reporting Requirements, and VM-51, Experience Reporting Formats. The data relates to life insurance policies; specifically, mortality, policyholder behavior and expenses.
  - 2) Data collection is expected to be expanded to include annuity and accident/health data in the future. These future phases will require defining the experience data needed for the particular business.
- B. Company policy-level data reporting to a data collection agent is required by the *Standard Valuation Law* (#820). The NAIC Company Experience Reporting Framework establishes guidance on the data-collection process for the purpose of developing mortality experience to support PBR
- C. NAIC senior management have developed an experience data-collection application using NAIC information technology resources to collect, cleanse and store the data. The application is currently being tested using actual company mortality experience data collected by the state of Kansas. The SOA has reviewed and commented on the form and format data-cleansing elements. NAIC staff continue to evaluate business intelligence tools that can be used to aggregate the individual company experience into aggregate industry experience that will be used to develop future industry Valuation Basic Mortality Tables.

### **IV. Evaluate Risk-Based Capital (RBC)**

- A. RBC requirements should be evaluated in light of valuation changes. Regulators should consider the appropriate impact on capital, given that:
  - 1) Reserves are being "right-sized."
  - 2) Appropriate reserve margins are still included in assumptions.
  - 3) Additional uncertainties (e.g., modeling errors) may be introduced into the calculations.
  - 4) The risks of inadequate reserves are expected to reduce over time, because the PBR approach automatically adjusts to actual experience as it emerges.
- B. The Life Actuarial (A) Task Force will monitor reserve volatility over time to determine any future need for a smoothing mechanism. If that is developed, RBC will also need to consider the appropriate impact on capital of such a smoothing mechanism.

**V. Prepare Accreditation-Related Recommendations for PBR**

- A. Revised accreditation standards for Model #820 have been proposed by the Life Actuarial (A) Task Force. The proposal will be considered by the Financial Regulation Standards and Accreditation (F) Committee at the Spring National Meeting.

**VI. Create State and Company PBR Education**

- A. A legislative brief and educational brief are available on the NAIC website. Education for state insurance regulators and regulatory staff has been developed. Through the negotiation efforts of NAIC staff, Actuarial Compass, an actuarial consulting firm, is providing access to its online training modules to state insurance regulators and regulatory staff at no cost. The SOA is making its online training available free for regulatory actuaries
- B. The SOA, with the assistance of a consulting firm, is developing a revised version of its *PBA Implementation Guide*.

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