

2019 Principle-Based Reserves (PBR) Review Report

From: Valuation Analysis (E) Working Group

To: Life Insurance Companies Subject to VM-20 and/or VM-21
Interested Regulators

RE: Findings from Review of 2019 VM-20 Reserves Supplements and PBR Actuarial Reports

Background

The Valuation Analysis (E) Working Group of the Financial Condition (E) Committee (VAWG) was formed to work with the NAIC Resources to support states in the review of PBR and uniformly address questions and issues arising from application of PBR.

This report provides a summary of the major findings from the VAWG's review of the 2019 VM-20 Reserves Supplement in the Annual Supplement Blanks (Supplement), and the 2019 PBR Actuarial Reports. The review of the PBR Actuarial Reports covered life insurance and variable annuities (for companies that elected to apply the VM-21 requirements applicable to the 2020 NAIC *Valuation Manual* as the requirements for the valuation on Dec. 31, 2019). **The PBR Actuarial Reports are considered to be confidential information under Section 14A of the Standard Valuation Law (Model #820), and may only be disclosed by a commissioner pursuant to Section 14B of Model #820. This report does not contain any company-specific or other company-identifiable information. The purpose of this report is to provide findings to aid state insurance regulators in their PBR reviews, and provide companies with feedback intended to assist with the preparation of future PBR Actuarial Reports and the VM-20 Reserves Supplement.**

Findings from Review of the 2019 VM-20 Reserves Supplement

The findings from the review of the 2019 Supplement were similar to those from prior years. For details, please see the VAWG [2017](#) and [2018](#) PBR Review Reports. To help address reporting issues, the Supplement was redesigned for 2020 filings, and the instructions were clarified.

The Supplement is an important tool for regulators since it facilitates their PBR reviews. Therefore, it is reviewed by NAIC support staff each year, and companies will be asked to resubmit their Supplement if it is found to be incomplete or inaccurate.

Major Findings from Review of the 2019 PBR Actuarial Reports

Overall, the PBR Actuarial Reports have improved substantially since 2017 for life products. For example, there has been greater use of graphs, tables, and spreadsheets, which were generally effective in conveying information succinctly and clearly. However, the findings noted in the VAWG [2017](#) and [2018](#) PBR Review Reports remain relevant, and companies are encouraged to review them. Findings included concerns regarding mortality assumptions, nonguaranteed YRT reinsurance, simplifications, assumption changes, materiality, exclusion tests, dates used for deterministic/stochastic reserve calculations, assets, organization and readability of reports, and governance and controls. With 2020 being the first year for the interim solution for non-guaranteed YRT, there has been some discussion and questions surrounding what is “guaranteed”. To clarify, if a contract has a five-year guarantee, then it is non-guaranteed after year five. If a contract specifies that the reinsurer may raise rates under some circumstances, but not others, then the contract is non-guaranteed.

Accelerated underwriting was an area of focus for the 2019 Life PBR reviews. The following concerns were noted:

1. A number of companies did not include an additional margin on their mortality assumptions for business subject to accelerated underwriting. Where historical mortality experience with the accelerated underwriting program is not yet credible, a margin should be incorporated until credible experience has emerged. A margin would be expected during this time period even for robust, stable accelerated underwriting programs that have been carefully constructed and analyzed.

Many accelerated underwriting programs may need a higher margin due to reasons including but not limited to: 1) limited back-testing, 2) limited ability to estimate or control for a sentinel effect in the anticipated differential in mortality between business subject to accelerated underwriting and fully underwritten business, 3) frequent changes in the accelerated underwriting program, and 4) a low volume of policies that went through accelerated underwriting.

2. Confusion was observed regarding two aspects of the mortality setting process: a) determining the anticipated differential in mortality between business subject to accelerated underwriting and fully underwritten business, and b) determining an additional margin to provide for adverse deviation, estimation error, and level of uncertainty. There should be both an anticipated differential and a margin for uncertainty in the anticipated differential. A smaller anticipated differential does not imply that a margin is not needed, and a larger anticipated differential does not imply that a margin is not needed.

For variable annuity business, some companies elected to early adopt the VM-21 requirements applicable to the 2020 NAIC *Valuation Manual* as the requirements for the valuation on Dec. 31, 2019. The PBR Actuarial Reports were reviewed for these companies. Based on this review, all companies with variable annuity business are encouraged to review the VAWG [2017](#) and [2018](#) PBR Review Reports.

Although these reports were based on a review for life insurance, many of the findings relate to variable annuities as well. In particular, companies should ensure that the PBR Actuarial Report is a readable, cohesive document, and that it retains and follows the order of the requirements listed in VM-31, as required by VM-31 Section 3.A. Also, there should be clear descriptions of company experience, actual to expected (A/E) ratios, and simplifications. Since the framework was revised to rely on a CTE(98) calculation for C-3 RBC, companies will be expected to demonstrate that the number of scenarios used is sufficient and provides stable results so far in the tail.

Additional VM-31 Reporting Considerations

Both life and variable annuity writers may find it helpful to review section VII of the VAWG [2017](#) PBR Review Report, which discusses the use of spreadsheets, tables, and graphs to efficiently and effectively convey information. It also recommends having the VM-31 report reviewed by another actuary not directly involved in the work or preparation of the report, to review the report for readability. Please note that the Academy's Principle-Based Reserving (PBR) Analysis Templates Task Force published [templates](#) to assist users when performing PBR analysis or preparing PBR Actuarial Reports required by VM-31. The use of these templates is optional.