**Life Actuarial (A) Task Force/ Health Actuarial (B) Task Force**

**Amendment Proposal Form**

1. Identify yourself, your affiliation and a very brief description (title) of the issue.

This APF was jointly prepared by the Office of Principle-Based Reserving, California Department of Insurance, and NAIC Support Staff.

New VM-20 Section 9.D.3.e and the edits to VM-31 Section 3.C.4 and VM-20 Section 9.D.6 address recommendations #16, #17, and #19 from VAWG’s 10/24/2018 memo regarding PBR Recommendations and Referrals to LATF.

2. Identify the document, including the date if the document is “released for comment,” and the location in the document where the amendment is proposed:

Valuation Manual (January 1, 2019 edition), VM-20 Sections 9.D.3.e, 9.D.6 and VM-31 Sections 3.C.4.a, 3.C.4.c, 3.C.4.d, and 3.C.4.k.

3. Show what changes are needed by providing a red-line version of the original verbiage with deletions and identify the verbiage to be deleted, inserted or changed by providing a red-line (turn on “track changes” in Word®) version of the verbiage. (You may do this through an attachment.)

See attached Appendix.

4. State the reason for the proposed amendment? (You may do this through an attachment.)

See attached Appendix.

NAIC Staff Comments:

|  |  |  |  |
| --- | --- | --- | --- |
| **Dates:** Received | Reviewed by Staff | Distributed | Considered |
| 1/30/19rev3/27/19 |  |  |  |
| **Notes:** VM APF 2019-11 (CA OPBR/NAIC PBR) | | | |

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#### Appendix

#### ISSUE:

#### The following VAWG Recommendations were made to address issues found during the review of the 2017 PBR Actuarial Reports:

* VAWG #16: Provide the definition of the expected basis used in all Actual to Expected (A/E) ratios shown in the PBR Actuarial Report.
* VAWG #17: Provide documentation of testing performed to determine whether there were post level term profits, including the assumptions used (premiums and anti-selective mortality and lapses) in the post level term period.
* VAWG #19: Provide results of testing performed to determine the direction of the lapse margin by duration.

#### SECTIONS:

**VM-31 Section 3.C.4, VM-20 Section 9.D.3.e, and VM-20 Section 9.D.6:**

VM-31 Section 3.C.4.a is being deleted since data sources are already requested in VM-31 Section 3.C.1.

VM-31 Section 3.C.4.c is being deleted since the method used to develop anticipated experience assumptions is already requested in VM-31 Section 3.C.1.

Re-numbered VM-31 3.C.4.c has edits to address VAWG Recommendation #16. Also, the required frequency for the A/E Ratios is changing to better align with the frequency of analysis for the policyholder behavior assumption.

Re-numbered VM-31 3.C.4.d and VM-20 Section 9.D.3 have edits to address VAWG Recommendation #19.

New VM-31 Section 3.C.4.k and revised VM-20 Section 9.D.6 have edits to address VAWG Recommendation #17.

#### REDLINE:

VM-31 Section 3.C.4

4. Policyholder Behavior – The following information regarding each policyholder behavior assumption used by the company in performing a principle-based valuation:

a. Data Reliability – Discussion of the reliability of the data and an explanation of why the data is reasonable and appropriate for this purpose.

b. Sparse Data – Explanation of how assumptions were determined for periods that were based on less than fully credible or relevant data.

c. Actual to Expected Policyholder Behavior Analysis – The results of the most recently available actual to expected (without margins) analysis, including:  
i. Definitions of the expected basis used in all actual-to-expected ratios shown.  
ii. Comments addressing the conclusions drawn from the analysis.

d. Margins and Sensitivity Tests – Rationale for the particular margins used and a description of testing performed to determine the size and direction of the margins by duration, including how the results of sensitivity tests were used in connection with setting the margins.

e. Impact of NGE – How changes in NGE affect the policyholder behavior assumptions.

f. Scenario-Dependent Dynamic Formulas – Description of any scenario-dependent dynamic formula.

g. Changes from Prior Year – Changes in anticipated experience assumptions and/or margins since the last PBR Actuarial Report.

h. Flexible Premiums – For policies that give policyholders flexibility in timing and amount of premium payments, the results of sensitivity tests related to the following premium payment patterns: minimum premium payment, no further premium payment, pre-payment of premium assuming a single premium and pre-payment of premiums assuming level premiums.

i. Anti-Selective Lapses – Specific to lapses, a description of and rationale regarding adjustments to lapse and mortality assumptions to account for potential anti-selection.

.j. Competitor Rates – Competitor rate definition and usage.

k. Post-Level Term Testing – For products with a level term period:

i. Summary results of the seriatim comparison of the present value of post-level term cash inflows and outflows for the DR as required by VM-20 Section 9.D.6.

ii. If this comparison showed there were post-level term profits, describe how anti-selection was handled in the post-level term period, including the prudent estimate premium, mortality, and lapse assumptions used.

1. If the comparison showed there were post-level term losses, confirm that the prudent estimate premium, mortality, and lapse assumptions for the post-level period were addressed in Section 3.C.1.a and were used in the reserve calculation.

VM-20 Section 9.D.3

3. Margins for Prudent Estimate Policyholder Behavior Assumptions

The company shall establish margins for policyholder behavior assumptions in compliance with Section 9.B subject to the following:

* 1. To the extent that there is an absence of relevant and fully credible data, the company shall determine the margin such that the policyholder behavior assumption is shifted toward the conservative end of the plausible range of behavior, which is the end of the range that serves to increase the modeled reserve.
  2. The company must assume that policyholders’ efficiency will increase over time unless the company has relevant and credible experience or clear evidence to the contrary.
  3. The company must reflect the data uncertainty associated with using data from a similar but not identical block of business to determine the anticipated experience assumption.
  4. The company shall establish a higher margin for partial withdrawal and surrender assumptions in the case where the company’s marketing or administrative practices encourage anti-selection.
  5. The company shall perform testing to determine whether the modeled reserve is materially impacted by variations in the size and direction of the margin and shall do so using a methodology that recognizes that the appropriate size and/or direction of a margin in the early durations may be quite different from that in later durations. If the impact on the modeled reserve is material, the company shall establish margins accordingly.

**Guidance Note**: For example, the lapse rate margins on a level term plan may increase lapses in the first few years (due to non-recovered acquisition costs) but decrease lapses for the remainder of the level term period (due to higher death claims).

VM-20 Section 9.D.6

Post-Level Term Period

a. For the calculation of the deterministic reserve, for a term life policy issued Jan. 1, 2017 and later in which level or near level premiums are guaranteed or expected for a specified duration, followed by a substantial premium increase, for the period following that substantial premium increase, the company shall compare the present value of cash inflows to the present value of cash outflows. If the present value of cash inflows exceeds the present value of cash outflows for the policy, then the company shall assume a 100% lapse rate at the end of the level term period so that no post-level term profits are reflected in the deterministic reserve calculation. If the present value of cash inflows is less than the present value of cash outflows for the policy, the post-level term losses shall be reflected in the deterministic reserve calculation.

b. For the calculation of the stochastic reserve for a term life policy subject to Section 9.D.6.a and for the calculation of the deterministic reserve and the stochastic reserve for a term policy issued before Jan. 1, 2017 in which level or near level premiums are guaranteed or expected for a specified duration, followed by a substantial premium increase, for the period following that substantial premium increase, the lapse and mortality assumptions shall be adjusted, or margins added, such that the policy’s present value of cash inflows in excess of cash outflows assumed shall be limited to reflect the relevance and credibility of the experience, approaching zero for periods where the underlying data have low or no credibility or relevance.

**Guidance Note:** A seriatim comparison of the present value of post-level term cash inflows and outflows must be performed. For policies subject to Section 9.D.6.a, the 100% lapse rate assumption at the end of the level term period applies only to those policies with post-level term profits. Similarly, for policies subject to Section 9.D.6.b, adjustments to limit post-level term profits must be made at a seriatim level, and post-level term losses must be reflected in the reserve calculations.

This does not preclude a company from using a simplified approach consistent with VM-20 Section 2.G. For example, testing on a representative number of key cells could be performed to verify that no post-level term profits are reflected in the deterministic reserve calculation.

**Guidance Note:** Section 9.D.6.b applies to a term policy issued before Jan. 1, 2017 that is valued using Actuarial Guideline XXXVIII.

#### REASONING:

These edits to VM-20 and VM-31 will fulfill the listed recommendations from VAWG.