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It's Time to Talk Principle-Based Reserving

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PBR is an updated approach to statutory-reserve requirements that was introduced by the National Association of Insurance Commissioners (NAIC). It went into effect Jan. 1, 2017, but the NAIC provided a three-year transition period before PBR became mandatory on Jan. 1, 2020.

Here's a look at what's changed, and what you should be prepared for.

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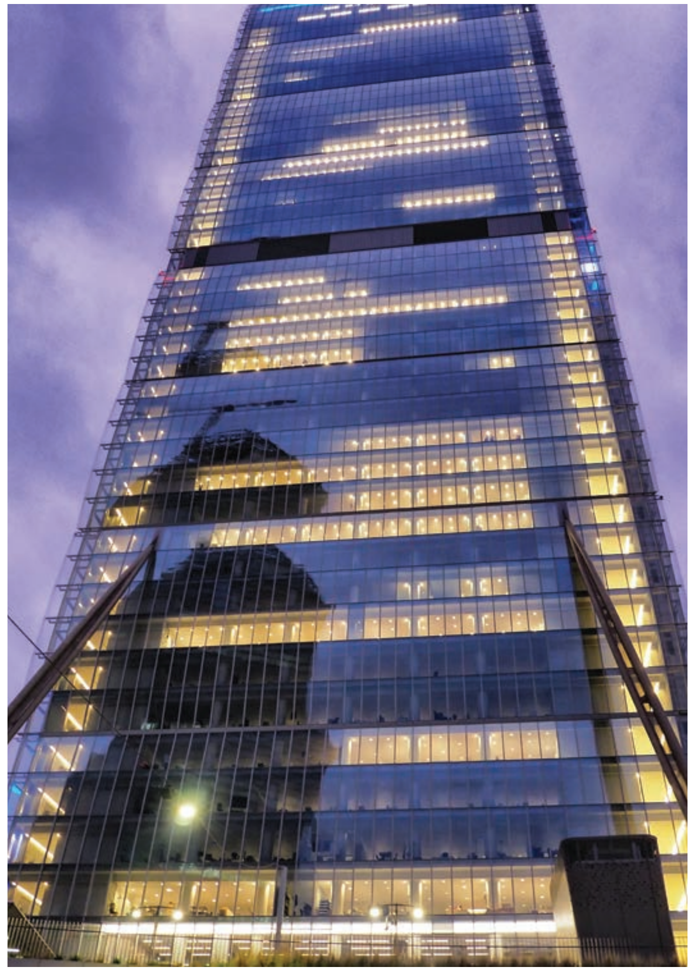

WHY THE NAIC TOOK ACTION

Before diving into the details of the new law, it's important to understand how insurers estimated reserves previously.

Prior to PBR, a rules-based approach to reserving was adopted by insurers to calculate capital needs. But because uniform assumptions and formulas were prescribed by state laws and regulations, it caused excessive reserves for some insurance products and inadequate reserves for others. In addition to updating this uniform approach, there were concerns by the NAIC that reserves calculated under those valuation standards didn't accurately reflect the features and risk profiles of certain products.

The "one size fits all" approach is now being phased out. The claim-paying obligation of an insurer is dependent on reserving calculations, so changing the standard will have a definite impact on the price of insurance. A high reserve may raise the cost of the policy, while a low reserve may impact the claims paying ability of an insurer.

THE NEW CALCULATION

Principle-based reserving, at its core, requires insurers to make complex calculations and establish assumptions based on their actual company experience, with additional margins added for prudency. This will result in substantial changes to processes, information technology systems and internal controls, and will introduce inter-company variability in capital required to back life-insurance policies. PBR will require insurers to calculate up to three separate reserve requirements and perform an assessment of internal control over their process to perform PBR valuations. An actuarial report must be filed with the insurance company's domicile state and made available upon request.

WHAT SHOULD YOU DO

While working through PBR implementation, here are tips to make it a successful transition:

- **Familiarize yourself with key recent amendments made to the NAIC's Valuation Manual.** These include clarifications on mortality assumption-setting—for example, how mortality aggregation for credibility works, disallowance of capping face amounts in studies, and the post-level-term (PLT) deterministic reserve limitation being seriatim—and a bevy of additional disclosure requirements for the PBR actuarial report. For a deeper dive on the impact of mortality credibility—one of the key drivers of the level of reserves—under a principle-based approach, check out this recent Society of Actuaries and Swiss Re publication.[1]

- **Make allowance for product filing delays.** These may occur because of new or refiled products getting to market simultaneously.

- **Engage with your reinsurers earlier in the pricing process.** That's because reinsurance cash flows will influence the price and profitability of your product. Also ask how they may be able to assist you with your pain points. ■

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ENDNOTES

1 Hasham, Alijawad, et al. 2019. Practical Analysis of PBR Mortality Credibility for Term Insurance. Society of Actuaries. June. *https://www.swissre.com/reinsurance/life-and-health/solutions/customer-retention/practical-analysis-of-pbr.html.*