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Principles-Based Reserves for Credit Actuaries

by Chris Hause

The current drafts of the principles-based reserves (PBR) model law and accompanying regulations appear to include credit life insurance within the scope. I would expect that once the scope of PBR is expanded to include accident and health insurance, credit disability will fall within its scope as well. How will this affect credit actuaries?

It is important to remember that single-premium credit insurance has no renewal premiums to recognize, so the PBR reserve calculation merely involves present values of benefits and expenses.

Also, there is no "cash value" to serve as a floor for reserves. In SSAP 59, it states that the *aggregate* reserve cannot be less than the *net* refund liability (after recognition of recoverable commissions and expenses). We hope that these important distinctions are left intact when considering how to apply PBR to credit reserves.

One of the historically aggravating aspects of compliance with the Standard Valuation Law for credit actuaries is that the aggregate reserves must satisfy the requirements of the state of filing. While most actuaries have said that it is nearly impossible to comply with this requirement due to (mostly) minor variations in state regulation, actuaries for widely licensed credit insurers have the additional discomfort of widely varying basic standards for valuation. This is chiefly because the Standard Valuation Law effectively ignores credit insurance.

LHATF has recognized this and set out to attempt to standardize reserving requirements for credit insurance.

Recently, we worked with LHATF and the A&H Working Group to adopt a modified 1985 CIDA table for valuation of active life reserves for single premium credit disability. These are codified in the Accounting Practices and Procedures Manual and several states have specifically adopted the model. However, for states that have (and choose to enforce) unearned premium requirements in their laws or regulations, the morbidity standard is rendered ineffective.

We also recently performed a comprehensive inter-company credit life mortality study and worked with LHATF to adopt a model regulation specifying the 2001 CSO Male Composite Ultimate Table as the minimum standard for credit life reserves. Again, many states have conflicting laws on the books that supersede the model.

So, in spite of the combined efforts of industry and LHATF at reserve relief and uniform standards for credit insurance, there continues to be more diversity than uniformity in reserving standards.

Credit life standards currently in use include:
1941 CSO
1958 CET
1958 CSO
1960 CSG
1980 CSO
1980 CSO times 150 percent
1980 CET
2001 CSO
130 percent of "Recognized Table"

Credit Disability standards currently in use include:
Pro-rata gross unearned
Rule of 78 unearned
Average of Pro-rata and Rule of 78
Greater of 130 percent of 1964 CDT at 4 percent and pro rata
Greater of 64 CDT at 3 percent and mean of R78 and pro rata.
Modified 1985 CIDA and Whole Life Interest Rate

Credit insurers have held grossly redundant reserves (usually 1958 CSO or CET) for so long, it has become a way of life. So, a positive effect of PBR is that perhaps one nationwide standard can be used by an actuary with confidence, unless the states continue to require "special" standards for credit insurance.

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If you would like to submit an article or be an associate editor, please call James R. Thompson at 815.459.2083

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If you must submit articles in another manner, please call Joe Adduci, 847.706.3548, at the Society of Actuaries for assistance.

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Thank you for your help.

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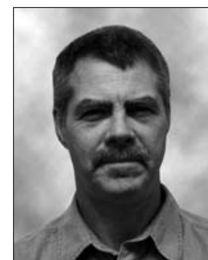
On the other hand, we have heard of a lot of nervousness about the requirements (and expense) for compliance with PBR, especially with the smaller carriers. Given that various market segments and states can have significantly different loss experience, there is much concern about homogeneity and credibility of experience.

The requirement to use actual assets in developing the present value calculations seems particularly absurd when considering the duration of credit contracts.

I believe that the best result for most credit carriers would be a uniform "safe harbor" mortality and interest rate, even if it produces redundant reserves. In addition to that, those companies that choose may use PBR if the expense of compliance outweighs the cost of the excess capital required.

In my opinion, this approach would not only serve industry, but would preserve simplicity and security for regulators as well. ●



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