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Chairperson's Corner

PBR is Here ... Pricing, Valuation and Risk Management in a New Paradigm

By Leonard Mangini

At the recent Life and Annuity Symposium in Nashville, I was a panelist for Session 21—also broadcast and available as a live SOA webinar—and discussed the impact that PBR will have on the Product Development Process. The main theme of my part of the presentation was that pricing, valuation/financial reporting and risk management actuaries will need to work much more closely together due to the impact that the Valuation Manual will have on assumption setting, reinsurance, and governance. This article touches on the high level themes and I invite you to explore the session slides or the full SOA webinar to see how your role as a qualified or appointed actuary might play out.

My first assertion was that pricing actuaries are typically closest to the underlying experience data and risk classification used to set prudent estimate assumptions. Qualified Actuaries (as defined under VM-G) who review and certify that PBR assumptions, methods and models are appropriate and Appointed Actuaries who opine on the adequacy of PBR reserves are likely to BOTH be relying on product actuaries for appropriate documentation of company experience. They will no longer be operating in silos setting their own assumptions, but will be working together and with risk management to have "one view of the truth."

The next assertion was that the role of reinsurance in the product development process would necessarily impact both product and financial reporting actuaries. Consider that the ceding company and each of its reinsurance pool members will have their own set of credible experience for a particular product potentially leading to different underlying assumptions and especially different credibility-based margins despite the same product design and underwriting. "Mirror-reserving" is gone in a PBR world. The ceding company may have early adopted PBR and the reinsurer might not have (or vice-versa). Both might have adopted, but one party might be holding a Deterministic Reserve (DR) and the other an NPR reserve for the same risk. The PBR reserve "credit" taken on the cedant's financial statements for reinsurance will be the difference between the reserve calculated by the cedant with and without reinsurance and NOT involve the reinsurer. If one of these is a DR and the other an NPR the impact of reinsurance won't be linear! If the reserve "credit" taken by the cedant and the reserve held by the reinsurer don't match (and they don't have to) this might not be economically reflected in the reinsurance rates! This suggests that reinsurers will and should be involved much earlier in the product development process and that both the pricing and valuation actuaries at these multiple counter-parties must be actively involved in discussions with each other from the start in determining the impact on reserves and emergence of profits for all parties.

Another assertion was that if the company does have "one version of the truth" as to the anticipated experience that is communicated to stakeholders, there will likely be different margins for pricing uncertainty, valuation conservatism, and solvency-level capital. In an ERM/ORSA world this impacts implementation of controls. Will assumptions and margins be "set on high"? Will pricing, valuation and ERM all have a seat at the table? Will these be set at the business unit level with governance and controls in corporate?

How will modeling be performed and therefore governed and controlled? Centralized teams with pricing and valuation and ERM as "internal clients"? Multiple independent business unit subject-matter expert modeling teams with separate corporate modeling teams for valuation and ERM to validate the results? Will financial reporting actuaries be the natural candidates for these modeling teams or ERM or "company quants" be doing this work?

Can corporate strategy be just within the purview of senior management? If block of business A is in the same "PBR segment" as block of business B which benefits from "internal hedging" and block A is sold in an M&A transaction it can change the PBR reserves and profitability for block B! Can you really have "secret corporate development teams" pursuing M&A that don't include a broader team of both product and valuation PBR technical experts to analyze these knock-on impacts?

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All of this will involve new processes and controls that must be integrated with the company's existing ERM program, internal audit, external audit and regulators. So valuation actuaries will need to be relying on pricing documentation, complying with VM-31 documentation and preparing PBR Actuarial reports, and interfacing even more with ERM and compliance functions of the insurer.

The common theme is that your role within the company is about to change and you'll be involved in much more than setting reserves. Please be on the lookout for a series of five PBR-related webinars that started in July and are being jointly sponsored by the Financial Reporting and Smaller Insurance Company Section Councils that address some of these issues. We also have sessions at the Valuation Actuary Symposium and Annual Meeting that might be helpful as you adjust to these changes. ■

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