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PBR Developments: What's Going on With the Valuation Manual?

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More than 40 amendment proposal forms (APFs) have been adopted by the NAIC's Life Actuarial Task Force (LATF) which would alter the 2018 edition of the Valuation Manual (VM). If ultimately adopted by the NAIC in plenary session these would impact 2019 valuations. Additional APFs may be adopted later in 2018 but would not take effect until 2020 valuations. This article covers some of the adopted APFs and one proposed APF that seem to the authors likely to be of interest to life insurance actuaries. The reader should consult the LATF website at *http://www.naic.org/cmte_a_latf*.htm after the Summer (August) Meeting of the NAIC.

MORTALITY GRADING

APF 2017-77 alters the grading of company mortality into industry mortality to make it a more continuous function of credibility.

In the 2018 edition of the VM, VM-20 Section 9.C.6.b.iii includes a look-up table with wide credibility bands to determine: a) the maximum number of years data can be considered sufficient, b) the maximum number of years to begin grading to industry experience after sufficient data no longer exists, and c) the maximum number of years in which mortality must grade to 100 percent industry experience from the duration where sufficient data no longer exists. APF 2017-77 introduces a new look-up table, mandatory for valuations performed on or after Jan. 1, 2020 and optional for 2019 valuations, with narrower credibility bands.

This is a significant change since it could impact a company's valuation software and its product pricing. The current wide buckets and sharp mortality grading cliffs have been smoothed out, so grading will likely change more frequently. Systems will need more frequent updating, but there will be fewer spikes and a company will not have to wait as long in order to get credit for improved credibility. Mandatory adoption of the new table was delayed until 2020 in recognition of the potential impact on valuation, pricing and the associated processes.

DISCRETION TO REDUCE EXPLICIT MARGINS

APF 2017-85 was adopted to make clear that the implicit margin referred to in VM-31, Section 3.C.11.c.i (i.e., ignoring mortality improvement past the valuation date), which can be reflected in estimating the impact of margins in the PBR Actuarial Report, cannot be taken into account in determining assumptions for use in calculating the VM-20 modeled reserves. The change also clarifies that prescribed margins for one risk factor cannot be taken into account when setting the margin for another risk factor, even if the prescribed margin is excessive.

DEFINITION OF ACTUARIAL OPINION

APF 2018-36 replaces the definition of "actuarial opinion" with a definition consistent with that in the Academy's qualification standard and thus requires compliance only with the General Qualification Standard, and not with the Special Qualification Standard that applies to an actuary signing the reserve opinion in the annual statement. Since the term "actuarial opinion" as used in VM-30 does mean the appointed actuary's opinion on reserve adequacy, the APF introduces the following language in VM-30 Scope Section 1.A: "For purposes of these VM-30 requirements, the words "actuarial opinion" means the opinion of an appointed actuary regarding the adequacy of reserves and related actuarial items pursuant to these AOM requirements."

CLARIFYING THE DATE OF THE 2015 VBT TABLE FOR MORTALITY IMPROVEMENT

APF 2018-10 clarifies that the date of the 2015 VBT table is July 1, 2015 for purposes of incorporating permissible historical mortality improvement through the valuation date.

CLARIFYING LANGUAGE REGARDING ULSG LAPSE RATES

APF 2018-30 clarifies that the secondary guarantee fund values (i.e., shadow account values) used in the lapse rate formulas of VM-20 Section 3.C.3.c.i that determine lapse rates applicable to the net premium reserve (NPR) component (applicable to the calculation of the NPR for ULSG policies during the secondary guarantee period) are the fund values on the valuation date and don't vary by duration.

GUARANTEED ISSUE CONSIDERATIONS

APF 2018-01 was adopted to introduce a more detailed and complete definition of guaranteed issue (GI) business in Section VM-01. It reiterates that inclusion of any of the following disqualifies a policy from being classified as GI: an "actively-at-work" criteria; employer groups; acceptance based on any health questions or criteria; waiving selection criteria based on participation levels for worksite-marketed products; COLI or BOLI business; credit life and pre-need insurance; juvenile business (issued to insureds under aged 15); or policies issued as a result of exercising a guaranteed insurability option.

This APF also stipulates that for minimum non-forfeiture requirements (and thus for reserve requirements) for GI issued before Jan. 1, 2020, the company must use the ultimate 2001 CSO table unless the company elects to use the non-preferred 2017 CSO for policies issued between Jan. 1, 2017 and Dec. 31, 2019. However, after Dec. 31, 2019 the new 2017 Commissioner's Standard Guaranteed Issue (2017 CSGI) tables in VM-M must be used. The company may elect to early adopt the 2017 CSGI for 2019 issues but this is not required, effectively providing companies with a grace period to reprice GI products and set up their systems and other processes and controls in order to handle this new CSGI table.

In addition, VM-M defines the 2017 CSGI as the 2017 GI Basic Ultimate table with a 75 percent loading. Some commenters noted that a 75 percent load might cause some pricing cells to face challenges complying with Section 7702.

REVISION OF VM-31

APF 2017-94 substantially restructures VM-31, primarily to rationalize the organization of the PBR Actuarial Report, but also to incorporate certain substantive changes in required documentation. The general requirements have not changed. For example, the report must still be prepared under the direction of one or more qualified actuaries assigned by the company under VM-G. Additionally, the criteria triggering whether a report must be submitted, the deadlines for its submission, and who may request the executive summary or full report are all the same. However, a paragraph was added to emphasize that a company that does not calculate a deterministic or stochastic reserve due to passing an exclusion test must still file a PBR Actuarial Report covering all relevant documentation, such as for the assumptions used in the exclusion test. It's anticipated that non-domiciliary jurisdictions will request to review the full report from companies licensed in their state.

The executive summary now covers both life insurance and variable annuities in a combined manner, so that materiality, for example, is defined similarly for both product lines. A new section on consistency between sub-reports, added by the APF, would require disclosure of material differences in methods, assumptions, or risk management practices between groups of policies or contracts (which would include differences between variable annuities and life insurance) unless these differences can be explained by variation in product features. There has been push-back on this requirement from the variable annuity community.

Section 3.C.1.c now requires that the life report include a catch-all documentation clause with "description of any considerations helpful in or necessary to understanding the rationale behind the development of assumptions and margins, even if such considerations are not explicitly mentioned in the Valuation Manual."

Section 3.C.2.a now requires that if more than one modeling system is used to develop cash flows, the report must describe how the modeling systems interact and Section 3.C.2.h requires that the deterministic reserve method applied to each model segment (the gross premium valuation method or the direct iteration method) be identified.

For non-guaranteed elements, the APF clarifies that a discussion of the impact of interest rates or other market factors on past and projected premium scales, cost of insurance scales and other non-guaranteed elements is now required, as is a description of any interest bonus included in the model.

For deterministic reserves that are allocated per VM-20 Section 4.C, details of the allocation must now be reported. Also, material risk offsets within a product group when calculating the stochastic reserve must be disclosed.

The other parts of Section 3 have essentially been re-ordered and have slightly different titles or numbering of their sub-sections but require similar documentation as the 2018 VM, although in some cases, the requirements have been more fully described, so the reader may wish to carefully review Section 3 in detail.

REVISION OF VM-50 AND VM-51

APFs 2017-81 and 2017-19 set forth substantial edits of VM-50 and VM-51 which are too detailed to describe here. Many of the changes concern the "experience reporting agent," the exact form that reports must take and legal concerns, such as ownership and confidentiality of data. A key technical change is that VM-50 now explicitly prohibits coding in any data other than what's known; that is, incomplete records should be marked as such and not filled in with placeholders.

AGGREGATION OF MORTALITY SEGMENTS FOR CREDIBILITY PURPOSES

APF 2018-17, if adopted, would clarify the conditions under which mortality segments may be aggregated in determining credibility and the sufficient data period. This APF includes new required reporting in VM-31 Sections 3.C.3.b and 3.C.3.m (the numbering reflects the changes introduced by the adopted APF 2017-94 discussed above).

If APF 2018-17 is adopted, companies would be able, with proper documentation and justification in the PBR Actuarial Report, to aggregate the mortality experience of different types of life insurance products (such as term, whole life, universal life) and different underwriting and risk classes within these products for purposes of determining credibility, provided that the underlying underwriting processes, including any impact on risk selection attributable to differences in distribution systems or target markets, are "similar." However, the intent is not to allow broad aggregation of disparate underwriting methods such as simplified issue and full underwriting. The APF clarifies that for assumed policies, "underwriting processes" are the processes by which reinsurers determine which risks to accept, and does not require looking through the treaty into their client's underwriting processes.

Under the APF, mortality segments may be aggregated if (1) they are subject to "similar underwriting" and (2) the aggregate mortality does, or potentially could, have an impact on the segment level mortality. Thus, the company cannot just determine mortality for segments independently and use the aggregated mortality only to determine the credibility. A company would have to demonstrate that a new underwriting process is expected to produce similar mortality to an existing underwriting process, or that any difference in mortality can be justified by external or internal studies to allow them to be considered similar for credibility purposes. Finally, the proposal requires applying a margin for uncertainty to expected mortality reflecting the degree of uncertainty inherent in the "innovative underwriting process."

Thus, if the APF is adopted, introducing new underwriting processes, such as accelerated underwriting, would not automatically cause the mortality segments to be "disaggregated," with low or even zero credibility (and correspondingly large prescribed mortality margins).

SUMMARY

As noted above, there are several dozen other APFs that have been adopted and due to space limitations we have to leave it to you to read and digest these for yourself. If you want to be more engaged with monitoring changes in the VM in real-time we suggest registering for and dialing-in as an interested party to regular LATF conference calls. If you're interested in actively shaping the direction of future changes to the VM we encourage you to become Academy of Actuaries volunteers. ■

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