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Defining the Details: Intricacies and Evolution of PBR Disclosures

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As companies transition to the next phase of their principle-based reserve (PBR or VM-20) implementation, their focus shifts from modeling and assumption setting toward financial reporting. A key step of financial reporting is developing the PBR Actuarial Report (VM-31). In September 2017, The Financial Reporter published an article titled "Reporting and Disclosure Requirements under VM-31" that summarized these reporting requirements. This article builds on that by covering the evolution of the VM-31 requirements and discussing lessons learned from PBR Actuarial Reports submitted by companies that reported reserves under PBR at Dec. 31, 2017.

EVOLUTION OF VM-31

The first section of this article describes the 2018 updates, 2019 updates and potential future updates to VM-31—Figure 1 provides a condensed summary. In addition, this section includes considerations for handling changes to VM-20 and selecting which Life Actuarial Task Force (LATF) approved VM-31 version to follow for each reporting year.

2018 VM-31 Revisions

During the National Association of Insurance Commissioners (NAIC) PBR Pilot Project[1], regulators and companies found that the 2017 version of VM-31 included redundant sections that left both regulators and companies unsure where in the report to provide key information. However, regulators found that most PBR Pilot Project participants used very similar formats for the PBR Actuarial Report and that a standard format facilitated a more complete review. In response to the feedback from the PBR Pilot Project, LATF formed a VM-31 Drafting Group to address these concerns by revamping the structure of VM-31. The revisions to VM-31 for 2018 (referred to as Phase 1 and 2) included important changes that:

(1) Minimized redundancies between the overview section and the main report by reducing the overview section to an executive summary, and

(2) required standardization of the report layout, with the addition of section headers for uniformity.

2019 VM-31 Revisions

There were additional proposed changes identified during the PBR Pilot Project that were not adopted into the 2018 Valuation Manual due to time constraints. These became Phase 3 of the VM-31 changes, which are planned to be adopted in the 2019 Valuation Manual.[2] These revisions are not as significant as the 2018 Valuation Manual changes to VM-31. The most notable changes are clarifications of how to handle reports covering only VM-21 contracts (i.e., variable annuities) or VM-20 insurance policies that pass both exclusion tests. The mortality reporting section also includes some restructuring and clarification.

Which Version Should I Use?

In general, the applicable version of VM-31 for year-end reporting will be the Jan. 1 edition for that year. However, since the 2018 revisions to VM-31 included improvements from both the company and the regulator perspective, some regulators suggested that companies could use the 2018 format for 2017 year-end reporting. This approach has the additional advantage of keeping the formats consistent for reporting in 2017 and 2018. Regulators may find it acceptable for companies to reflect the 2019 Valuation Manual revisions for the 2018 PBR Actuarial Report, but companies should first consult with their domestic regulator.

VM-31 Planned Revisions

For variable annuities (VM-21), the Variable Annuities Issues Working Group has agreed to make substantial changes, including changes to the standard scenario, prescribed policyholder behavior assumptions, economic scenario generation, modeling of hedges and revenue-sharing income. Regulators and interested parties agreed that disclosures must be revised to reflect these changes, as well as generally refined to allow regulators to better assess the reasonableness of the more complex aspects of VM-21 modeling. Efforts to update the disclosures are ongoing. In addition, the lessons learned from revising VM-20 disclosures can be applied to VM-21 reporting requirements. Current reporting requirements are scattered throughout VM-21, including some redundancies and ambiguous sections. LATF has formed a VM-21 Reporting Drafting Group that will propose improvements to VM-21 reporting. Improvements are expected to include clarifications, consolidations, and additional structural updates.

Since VM-31 currently refers the reader to VM-21 for disclosure requirements on applicable business, any revisions to VM-21 may impact VM-31 and the PBR Actuarial Reports. Beyond this, there are currently no planned restructurings to VM-31. However, all regulators and interested parties may

Figure 1
Key Changes To VM-31 Reporting Requirements

Report element	2018 updates	2019 updates
New sections	Adds a requirement to summarize changes in reserve amounts in the executive summary	Adds requirements to disclose consistency between sub-reports, additional assumption considerations, Deterministic Reserve (DR) method (VM-20 4.A vs. 4.B), pre-reinsurance assumptions, interest bonuses, and DR allocations to product groups
Old section updates	Deletes or moves requirements related to assets, disclosures, and others from the overview to the main report, and re-labels overview as executive summary	1) Clarifies that descriptions of modeling systems are required for both assets and liabilities, and that non-medical/clinical published reports may support mortality adjustments 2) Adds non-guaranteed element (NGE) disclosure clarification for past practices and policies
Structure	1) Adds requirements for standard report format and section headers for each requirement 2) Consolidates reliances, signatures, certifications 3) Moves some asset and risk management requirements to the main body of the report	Moves the experience studies and industry table descriptions to earlier within the mortality subsection of the report
VM-21	Adds guidance note directing that for variable annuity contracts, after completing the first two sections of the executive summary, the reader may skip directly to Section 3.E, which directs them to VM-21 for variable annuity reporting requirements	Clarifies that the closing section of the executive summary must be completed for VM-21 business
Other	The executive summary of the VM-31 Report must now be submitted to the domestic commissioner each year; the executive summary and the entire PBR Actuarial Report must, upon request, be submitted to the commissioner of any state in which the company is licensed	Clarifies in the general requirements section that products passing exclusion tests must still have a PBR Actuarial Report prepared

submit amendment proposals for LATF to consider revisions to VM-31, in addition to other sections of the Valuation Manual. As PBR requirements for other products evolve, further changes to VM-31 may be needed.

VM-31 Considerations For Amendments To VM-20

The reporting requirements in VM-31 for life insurance policies are intended to document that the company has followed the valuation requirements of VM-20. Thus, amendments to VM-20 may impact how companies construct the VM-31 PBR Actuarial Report. Examples are:

- ULSG lapse rates—VM-20 Section 9.D.5 requires that *Lapse Experience Under Term-to-100 Insurance Policies* published by the Canadian Institute of Actuaries in October 2007 be used for ULSG policies with zero or minimal cash surrender value. In 2018, an amendment proposal was passed by LATF that will change the requirement to an updated, September 2015 study starting with year-end 2019 reporting. Thus, companies must monitor changes not only to VM-31 but also changes to VM-20 that affect valuation disclosures.

- Credibility aggregation—A VM-20 amendment proposed in 2018 provides more guidance around whether a company can determine credibility at an aggregate level across mortality segments. The proposal includes several references to allowing flexibility in aggregation if support is provided in the PBR Actuarial Report. While regulators have tried to keep valuation requirements in VM-20 and reporting requirements in VM-31, this is an ongoing process, and the dividing line is not always clear.

- Term shock lapse—The reader should carefully distinguish between a prescribed method and a prescribed safeguard. For example, VM-20 Section 9.D.6 states that, for the deterministic reserve, the company cannot reflect post-level term profits. This does not state that a company must always use a 100 percent shock lapse, as the company must use a prudent estimate shock lapse assumption if expecting losses after the level period. Therefore, the company should support a 100 percent shock lapse assumption, when applied, based on materiality and an analysis of whether profits or losses are expected after the level period that is documented in the PBR Actuarial Report. Without noticing this nuance, the company may fail to provide appropriate support in its PBR Actuarial Report.

- Reinvestment strategy guardrail—The "alternative reinvestment strategy" of VM-20 section 7.E.1.g is not always required to be used; instead, the company should demonstrate in the VM-31 PBR Actuarial Report whether the company assumption is less conservative than the guardrail, and only use the guardrail if constraining.

PRACTICAL CONSIDERATIONS OF VM-31 REPORTING

The second section of this article provides practical insights on the reporting process of VM-31. In addition to providing tips for a company to create its VM-31 PBR Actuarial Report, this section also gives perspective on the characteristics of the 2017 reports submitted in 2018.

VM-31 Reporting Process

Creating the PBR Actuarial Report can be a daunting task for a company as the report is meant to capture all the details of the PBR valuation. However, if started early and the qualified actuary is able to leverage documentation from other areas of the company, this initiative becomes much more manageable. Below, we have laid out tips for a company to complete its PBR Actuarial Report in an accurately and timely manner:

1. Read the requirements of VM-31 before starting your PBR implementation, as there are downstream implementation requirements that will be much easier to address during the early stages of implementation (e.g., coding sensitivity tests or setting up a model for PBR safeguards)

2. Leverage as much as possible from other parts of the company. (See Table 1 for examples.)

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Table 1
Examples Of Items That Can Be Leveraged From Other Sources

Source	Section(s) leveraged
Asset Adequacy Testing reports	Product descriptions and assumptions
AG43, AG48 and AG38 8D reports	Modeling systems and characteristics
Own risk and solvency assessment (ORSA) documentation	Company risk management
Investment policy statements	Reinvestment strategy

3. Create a VM-31 "shell" and then assign each section to a "section owner." Many of these sections are mutually exclusive and will be handled by different areas of the company at various times of the calendar year.

4. Create a "mock report" using prior period data and target getting this through corporate governance before the rush of year-end reporting work.

5. Make use of a SharePoint site or other tools to prevent version control issues and to facilitate quicker review.

VM-31 Characteristics For 2017

Twenty-three companies moved at least one product to PBR in 2017. These companies sold over 278,000 PBR policies and held net VM-20 reserves just below $300 million.[3]

The general structure of VM-31 PBR Actuarial Reports was often consistent across companies. As discussed above, many companies used the 2018 version of the VM-31 requirements rather than the 2017 version. However, the content of individual sections differed across reports, sometimes dramatically. Some companies provided extensive detail in the body of the report, others provided brief descriptions with references to appendices, and still others submitted brief reports with generic statements. This was seen in several sections, including assumptions related to mortality, policyholder behavior, assets, modeling and reinsurance. For example, when disclosing lapse rates, one company may have shown detailed actual/expected analyses, lapse rate tables and sensitivities, whereas another company may have included a more general description. Because of this variability in disclosure granularity, as well as differences in products covered and the application of exclusion tests, report lengths varied from 30 pages to hundreds of pages. Shorter reports may result in a longer follow-up dialogue with regulators, and longer reports often contain tables of information better suited for spreadsheet format. Companies are encouraged to discuss with their domestic regulator what format best facilitates review.

Additionally, some companies used the argument that a calculation element was "immaterial" to explain why no analysis was disclosed. This was more common with margin assumptions shown in a simplified manner with little or no additional information. For example, some companies used alternate data sources when data was not credible without adding margin to reflect the level of uncertainty. Regulators are likely to request either clear support that the item is immaterial or clear justification for the assumption and margin, including the level of additional margin when there is increased uncertainty.

In addition, sensitivity tests and analyses used to determine margins were not always clearly documented in the report. Companies may have been able to mitigate this lack of detail by adding more background in appendices. Yet some appendices were fairly brief and did not add significant detail. After the NAIC PBR Pilot Project, LATF issued a report[4], which included major findings and observations including that "no single report was fully complete; however, some reports provided significantly more detail than other reports." Regulatory review of the 2017 reports, including the focus of the Valuation Analysis Working Group (VAWG), will assist in establishing the level of disclosure required for a regulatory actuary to assess the reasonableness of a company's PBR valuation.

CONCLUSION

Since the article "Reporting and Disclosure Requirements under VM-31" was published (*The Financial Reporter*, September 2017), the industry remains at various levels of preparedness; some companies are still establishing processes while other companies are now refining processes after their first Life PBR valuation. However, the industry as a whole is moving along the preparedness curve, with some leading the way toward well-prepared and well-formulated principle-based valuations. Because the Valuation Manual is a living document, the numerous changes to VM-20 and VM-31 reporting requirements and the addition of more business under PBR (new products, new legal entities) introduce challenges that companies and regulators are still addressing. It is recommended that companies be aware of impending changes to VM-20 and VM-31 and effectively document and communicate the analyses performed, as this will enhance the company PBR reporting process and facilitate communication with auditors and regulators. ■

The view and opinions expressed in this article are those of the authors, Benjamin Slutsker, Rachel Hemphill, Kevin Piotrowski and Hugues Fontaine, and do not necessarily reflect the official view of their employers.

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ENDNOTES

1 In 2015, the NAIC PBR Implementation (EX) Task Force voted to charge the PBR Review (EX) Working Group to work with the NAIC and state insurance departments on reviewing mock VM-31 reports provided by volunteer companies. This initiative was named the NAIC PBR Pilot Project.

2 Phase 3 VM-31 changes were adopted by LATF in April 2018 and NAIC (A) Committee in July 2018. They are currently pending Exec/Plenary Adoption as of the date this article.

3 2017 annual statements from individual companies, S&P Global Market Intelligence Platform, 4 April 2018.

4 *http://naic.org/documents/cmte_ex_pbr_implementation_tf_related_company_pilot_project_report.doc*