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VM-31: Modifications and Findings for 2020 Reports

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This calendar year introduces many changes for life insurance companies. In addition to the emerging developments related to the pandemic and the economic environment, 2020 is the first year that all U.S. life insurance companies will be required to comply with VM-20 for life insurance products and the recent significant revisions to VM-21 for variable annuity products. This article focuses on the VM-31 principle-based reserve (PBR) Actuarial Reports associated with these new requirements. In particular, it summarizes new modifications for 2020 year-end reporting disclosure requirements for life insurance, variable annuities (VA), and differences between the two. It then concludes with a description of initial findings from 2019 year-end VM-31 PBR Actuarial Reports and future considerations.

KEY CHANGES TO VM-31 FOR LIFE INSURANCE

As more companies adopt VM-20 and file Life PBR Actuarial Reports, regulators have observed gaps and inconsistencies in reporting across the industry. As a result, PBR reporting requirements for life products have expanded significantly in 2020. While some changes are non-substantive, others require companies to include additional documentation and disclosures over what was included in 2019 reports.

Major updates include new required Excel templates, assumption tables for each material risk, and a new section for riders and additional benefits. In addition, some VM-20 valuation updates have new associated VM-31 disclosures, such as a new Deterministic Exclusion Test (DET) Certification Method disclosure requirement. Figure 1 outlines key new life reporting requirements added to the 2020 Valuation Manual (VM).

Figure 1

New Life Reporting Requirements Added to the 2020 VM

VM-31 Section	Requirement
2. General Requirements	• Report must be in the format of a searchable PDF, but can include any charts, graphs or spreadsheet attachments.
3.B. Executive Summary	• Required template for summarizing all policies covered by VM-20 • Summary of results for current and prior year, net and gross of reinsurance
3.C. Life Summary	• Any significant unresolved issues with principle-based valuation • Statement indicating governance documentation is available upon request
3.D. Life Report	
3.D.1. Assumptions and Margins	• Complete assumption tables in Excel format for each material risk • Required template with details on experience studies for each risk factor
3.D.2. Cash-Flow Models	• Additional details on model vendor, version, customization, process outside of model and model validation
3.D.3. Mortality	• Additional justification for aggregating mortality experience (if applicable) • Additional disclosure of post-level term mortality assumptions and details on credibility/improvement
3.D.4. Policyholder Behavior	• Description of testing performed to determine size and direction of margins • Seriatim post-level term testing, including how anti-selection is reflected
3.D.5. Expenses	• Treatment of commissions and acquisition expenses
3.D.8. Reinsurance	• Relationship with reinsurers (affiliated/non-affiliated, captive/non-captive, etc.)
3.D.10. Exclusion Tests	• Results of each component of Stochastic Exclusion Ratio Test (if applicable) • Support for DET Certification Method (if applicable)
3.D.11. Additional Information	• Additional details for sensitivity tests and simplifications • Statements regarding which calculations were performed as of the valuation date, or as of a date preceding the valuation date • Breakdown of universal life with secondary guarantee (ULSG) reserve results into variable, indexed, and regular universal life (UL) • Description of how PIMR balance is derived and allocated among model segments
3.D.12. Riders and Supplemental Benefits	• Description of coverage provided, separate premium or charge, how valued, and where the reserve is recorded
3.D.14. Certifications	• Additional certification from qualified actuary for DET Certification Method

KEY CHANGES TO VM-31 FOR VARIABLE ANNUITIES

The 2020 VM contains significant changes to VA disclosures. Although some companies have implemented these changes for 2019 year-end, most companies will be reporting the new disclosures for the first time at 2020 year-end.

Structure

In Actuarial Guideline 43 (AG 43) and early versions of VM-21, documentation requirements were interspersed throughout the regulation. Aside from a few larger documentation sections, VM-21 also contained instances of a single disclosure hidden among other valuation requirements. In the 2020 VM, all VA reporting items are consolidated in VM-31, primarily the VA summary and VA report, with some high-level results in the executive summary. In addition, VA reporting now has a required standard outline to facilitate report development and review.

Updated Sections

Prior reporting requirements were often presented in outline form, which have now been updated with more detail.

For hedging, there are now additional reporting items on back-testing, including documentation on the error factor and CDHS. Documentation is required if the company elects the safe harbor and to justify if the CTE70 (best efforts) is below both the CTE70 (adjusted) and the fair value. For scenarios, documentation on calibration was replaced with documentation that the use of non-prescribed generators does not reduce the total asset requirement (TAR) compared to the prescribed generator. Documentation was added for scenario reduction techniques, proxy funds not within scope of the prescribed economic scenario generator (ESG), and implied volatility. Asset disclosures are now located in separate sections for general and separate accounts, and more details are required for reinsurance agreements. In addition, certifications are now part of the report rather than separate submissions.

Sections Added and Removed

There are new sections that reflect updates to the valuation requirements, most notably the additional standard projection amount and its two calculation methods—CTE with prescribed assumptions (CTEPA) and company-specific market paths (CSMP). These include disclosures for cumulative decrement analyses and the Withdrawal Delay Cohort Method. There is a section to report the details of the phase-in, if applicable.

Other sections cover prior items that were relevant but not always explicitly disclosed: materiality, material risks, allocating reserves to individual contracts, and contract loans. Exhibit LR027 in risk-based capital (RBC) reporting may optionally be included and the standard scenario section was removed, along with the statement that the actuary is not opining on the adequacy of surplus or the future financial condition. In lieu of the prior sensitivity testing section, some individual sections discuss sensitivity testing (e.g., utilization) although others do not (e.g., lapse).

The NAIC Life RBC Working Group also recently modified instructions for the phase-in and smoothing for 2020 LR027 C-3 RBC calculations, to avoid a reduction to the TAR due to voluntary reserves that had been held in prior years but are no longer held.

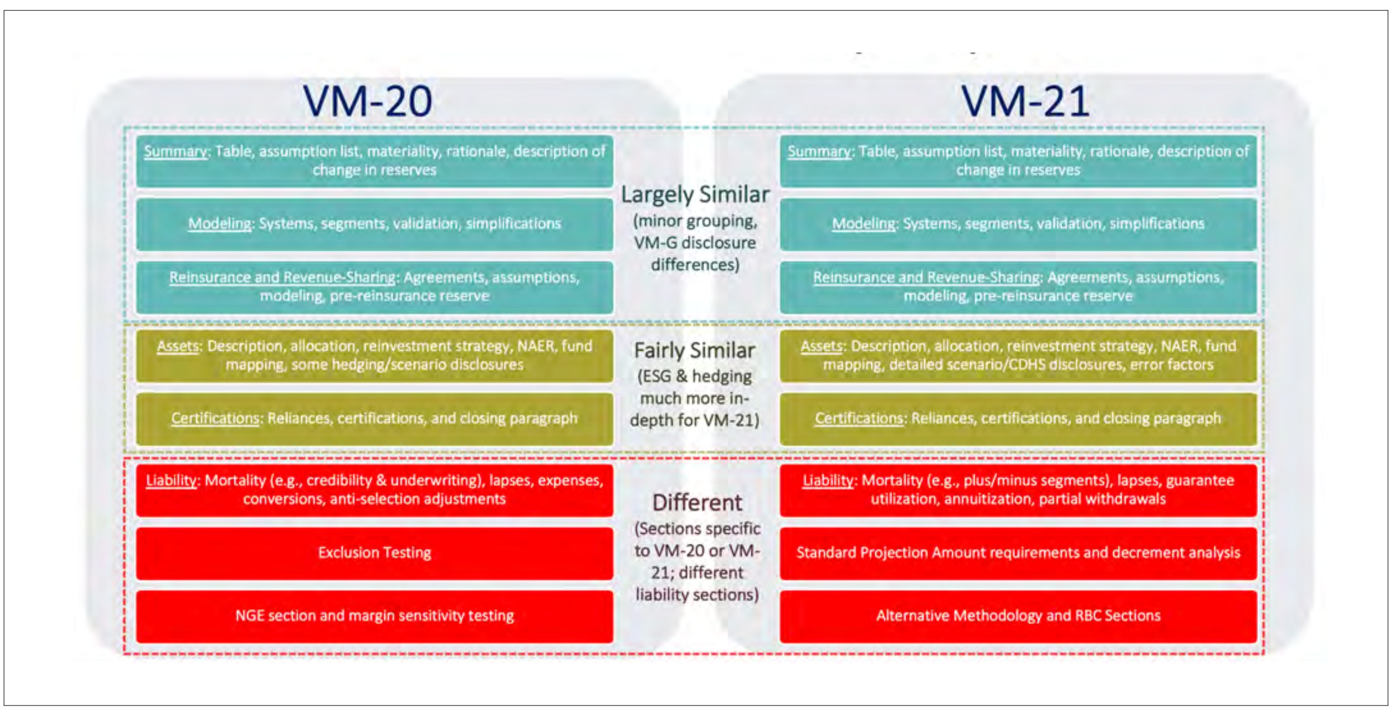
COMPARISON BETWEEN VM-20 AND VM-21

The updates to the VM-21 documentation requirements not only significantly modify the prior requirements, but also more closely align the VM-21 requirements with the required VM-20 disclosures. A company writing both life and VA business would find it beneficial to leverage one VM-31 report when developing the other. Given that aspects of the requirements are identical, it may even appear inconsistent or strange for the two disclosures to look uncoordinated. For companies with siloed life and VA teams, it is recommended that the two coordinate leading up to the first report submission.

Figure 2 compares VM-20 and VM-21 disclosures across different attributes (using the 2020 VM). First off, the two share the VM-31 executive summary, which must be completed for all policies valued under both VM-20 and VM-21. There also are similar requirements for listing out assumptions and providing an overview.

Even the asset sections are very similar between VM-20 and VM-21; VM-21 contains the VM-20 asset requirements plus additional requirements related to hedging and scenario generation. Certifications in VM-20 and VM-21 are nearly identical, except that VM-20 also has additional certifications related to exclusion tests. Where life and VA requirements clearly differ are in a few sections specific to each framework's methodology: exclusion testing and NGEs for VM-20, additional standard projection amount, alternative methodology, RBC, and annuitizations/partial withdrawals/utilizations for VM-21.

Figure 2
VM-20 vs. VM-21 Disclosure Requirements



INITIAL 2019 FINDINGS AND FUTURE CONSIDERATIONS

Life

Companies implementing PBR could still benefit from reviewing an analysis of the 2017 and 2018 PBR reports that was conducted by the NAIC's valuation analysis working group (VAWG), and which is available under "Related Documents" on the NAIC's VAWG website. While companies that filed their second or third VM-31 report in 2019 incorporated follow-up requests from prior years, many of the new adopters had issues consistent with those cited in the VAWG report. Most of the observed issues relate to the VM-20 calculations rather than the VM-31 reporting requirements including, for example, using Bühlmann credibility for simplified issue business, not applying the starting asset collar correctly, or not updating to the 2015 CIA lapse table for ULSG policies.

While the 2020 VM reflected a significant number of amendments, there has been a marked slowdown in amendments for the 2021 VM, recently reinforced by industry and regulator focus on COVID-19 related efforts. One project that the industry and regulators have been jointly pursuing is non-guaranteed yearly renewable term (YRT) field testing to inform a permanent approach to handling non-guaranteed YRT in PBR, which could replace the current approach of requiring the unearned tabular cost of insurance (i.e., ½C_X) pursuant to statement of statutory accounting principles (SSAP) No. 61. It was previously acknowledged that this project had an ambitious timeline, and with the industry and regulators now focused on COVID-19 related efforts, potential amendments are expected to now target implementation in the 2022 VM.

Variable Annuities

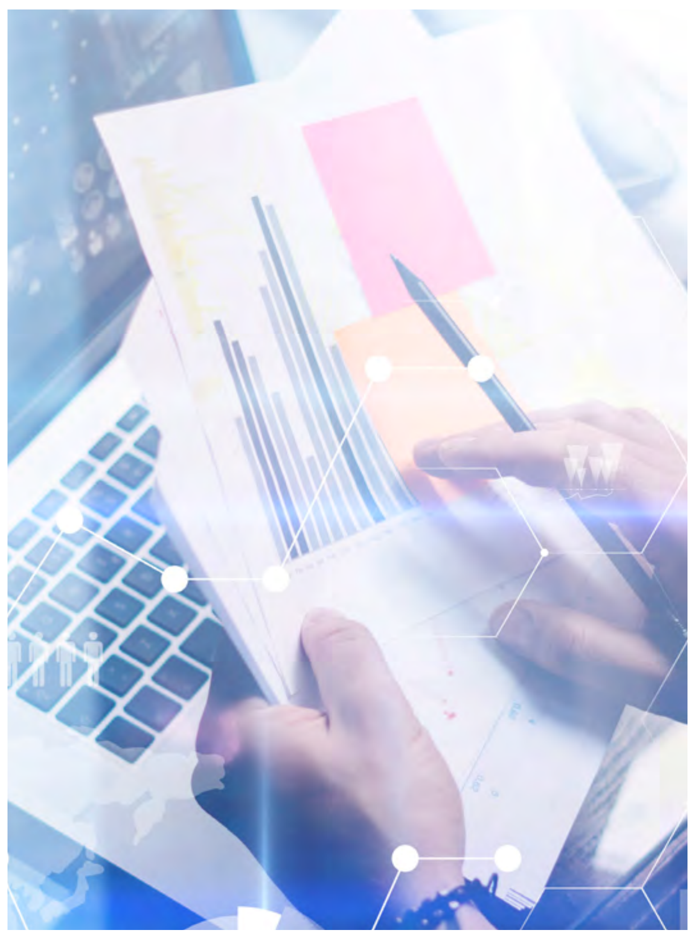
The NAIC's VAWG will be reviewing the 2019 early adopters of the new VA framework, which is likely to result in public guidance to companies, similar to that previously provided for life PBR. Systematic issues may be included in a public report, and individual issues will be discussed directly with companies. Early findings reveal some systematic reporting issues, including:

- Insufficient documentation for items previously only maintained "on file," such as CDHS;
- vague materiality discussions;
- inefficient reporting, including repetitive sections that could be made more succinct through the use of tables, or the inclusion of tables within the PDF report which are better suited for Excel attachments;
- providing actual-to-expected (A/E) ratios with "E" only on a prudent basis and not also an anticipated experience basis; and
- lack of support indicating why the number of scenarios that were run is sufficient, especially for a reliable conditional tail expectation at the 98th percentile (CTE98).

ADVICE FOR FUTURE VM-31 REPORTS

Initial VM-31 report submissions have tended to be brief and sometimes do not expand upon certain aspects of the valuation method, process or business. However, showing less may lead to more questions, and more work to ensure regulators are comfortable with the company's PBR reporting. Don't be afraid to provide more information in order to help regulators understand and get comfortable with the methods, assumptions and results. Providing more information up front will in turn save time and effort in responding to questions and requests for additional information after the fact. It is recommended to think about how companies got comfortable with their PBR reserves and put that forward in the VM-31 report.

In addition, don't write PBR reports in a vacuum. There are several documentation requirements already in place (and future requirements on the horizon). Leverage work done for asset adequacy testing, own solvency risk assessment (ORSA), GAAP unlocking, corporate governance frameworks, and even the new long duration targeted improvement (LDTI) disclosures. While



the format of VM-31 is specified, much of the content may have already been created for other purposes and can be leveraged.

Finally, focus on continual improvement. There is an expectation that these reports won't be perfect the first time—but it is suggested to focus efforts each year to improve upon the prior year's report. This does not necessarily mean just appending new information; it also means removing information that is confusing, not relevant, or could be shown in a better format. While many worry about the length of the document, it may be beneficial to instead focus on completeness and clarity in conveying whether reserves are appropriate and reflect relevant risks under the statutory accounting requirements.

The views expressed in this article are solely the views of Angela McShane, Benjamin Slutsker and Rachel Hemphill and do not necessarily represent the views of their respective firms. The information presented has not been verified for accuracy or completeness and should not be construed as legal, tax or accounting advice. Readers should seek the advice of their own professional advisors when evaluating the information.

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