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Section Council Sponsors IFRS Research

by Tom Herget

The SOA has completed its study of IFRS accounting impacts on popular U.S. products. Members and other interested readers can find the study on *www.soa.org/research/research-life.aspx*.

The International Accounting Standards Board (IASB) has been studying insurance accounting for 10 years. They are closing in on concluding initial research and are now sharpening their pencils for writing new standards for insurance accounting.

The IASB issued its Discussion Paper last May. It contained preliminary views and rationale for an initial draft of accounting principles. Naturally, it contained elements that both pleased many constituents and alarmed others.

In order to help the United States actuarial profession establish its position on these new accounting principles, the American Academy of Actuaries (AAA) asked the Society of Actuaries (SOA) to conduct a research project. The Financial Reporting Section Council accepted this challenge. It organized a Project Oversight Group (POG) which in turn retained a consulting firm, PricewaterhouseCoopers (PwC) to lead the study.

The POG then recruited 20 Actuarial Task Forces (ATFs). The ATFs were small calculating teams who applied IFRS principles to real blocks of business and real products. We thank the companies and firms (AFLAC, Beneficial, Cincinnati Life, Deloitte & Touche, Ernst & Young, Kaiser Foundation Health Plan, Manulife, MetLife, Milliman, New York Life, Ohio National, Symetra and XLRe) who provided real products, real inforce blocks and real people to perform the calculations.

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The ATFs provided projections of GAAP income statements and balance sheets along with the various cash flow components needed for IFRS computations. The assumptions surrounding the projections were provided for comparison to other submissions. They also provided various sensitivities around their specific product along with observations or comments.

The results were provided to PwC who reviewed and vetted. The POG also weighed-in on approaches and results. Once all 20 ATFs reported numbers, PwC then wrote a report on the results. The report included graphs of the resulting net income under both existing GAAP and the proposed IFRS. Sensitivities and alternative views were also explored with respect to the risk margin and discounting proposed by the IFRS DP and the resulting impact on net income was shown. Comparison of the GAAP net liabilities to the proposed IFRS liabilities were also prepared and displayed. Many items were identified that were either not addressed in the IFRS DP or may warrant future research.

These results have been forwarded to the Academy who in turn has submitted them to the IASB and the FASB. The FASB has requested comments from its constituents as to whether users feel IFRS could be a suitable replacement for U.S. GAAP.

There are two results we are hoping for. One is that the accounting rule-makers can see the impacts, the pros and the cons, of the principles they espouse. The second outcome is to educate the United States practioners as to what they can expect in the way of results and calculation process.

The IASB will now evaluate all responses (over 150) to its Discussion Paper and use information learned to prepare an Exposure Draft with, presumably, revised proposals. In doing this, it will collaborate with the FASB which will most likely join in the project in the third quarter of 2008. The Exposure Draft will be issued more than a year from now. We will probably have a second chance to do research on these updated principles.

The Section Council appreciates the hard work performed by the ATF's, the researchers, and the POG. $

PBA Corner

by Karen Rudolph

(Editor's note: Karen Rudolph has agreed to supply the Financial Reporter with regular updates on PBA activities. Thanks to Karen and watch for future updates in the PBA Corner.)

Activity surrounding the principle-based approach (PBA) to statutory reserves and minimum regulatory capital is gaining momentum. The regulatory community, actuarial profession and insurance industry in general have contributed significant effort to fuel the progress to date. As the deadline for this issue of *The Financial Reporter* nears, the NAIC's Life and Health Actuarial Task Force (LHATF) scheduled an unprecedented number of days combing through the documents included in the proposed Valuation Manual (VM), as well as endeavoring to adopt the revisions to the Standard Valuation Law (SVL-II) that recognizes the VM as the repository for statutory accounting reserve requirements. This article will allow those readers who are not as close to this initiative to quickly become familiar with the landscape of the movement and where it stands today.

The work products have been many and varied. At this stage, all reserving requirements, both principle-based and formulaic methods, will be found in the VM. Following is an overview of the six sections of the VM and some important elements of each. The first five sections refer to one or more minimum standards found in the final, sixth section. Much of the content in these sections is in draft form and subject to change.

I. Introduction. The reserve requirements found in the VM satisfy the minimum statutory valuation requirements of the SVL. These requirements are applicable to life, annuity, deposit-type contracts and health insurance business. The operative date of the VM is January 1 following the date that: (1) the VM (or a change thereto) is adopted by at least 75 percent of the NAIC executive and plenary members; and (2) at least 39 states have adopted the revised SVL. This section also includes the process for updating the VM.

II. Reserve Requirements. This section lays out the scope of the VM and maps any particular business type to the appropriate requirements. For example, for life insurance contracts in force on the operative date of the VM, this section specifies applicable state requirements as the minimum standard. For life insurance contracts issued on or after the operative date, the minimum requirements found in VM-20 are applicable. VM-20 is the Requirements for Principle-Based Reserves for Life Products and is found in a later section of the VM. Whether a contract qualifies as a life contract is specified in VM-2.

III. Reporting Requirements. Companies are subject to each of two types of reporting requirements: the Actuarial Opinion and Memorandum (VM-30) and the Principle-Based Reporting Requirements (VM-31).

IV. Annual Principles-Based Review Requirements. The scope and responsibilities of the reviewer and the company are found in VM-40. At the winter NAIC national meeting however, this section was removed from the manual. The disposition of peer review requirements for principle-based valuations is to be determined. Review requirements found in VM-40 will likely be retained in some way, whether by inclusion in the Financial Examiner's Handbook or some other state-specific requirement. The frequency of the review is also unknown and may be at the discretion of the state.

V. Experience Reporting Requirements. The scope and content of experience reporting is still under development. VM-50 and VM-51 outline these requirements and the associated formats for submissions.

VI. Valuation Manual Minimum Standards. This is where the detailed content resides. Sections I through V point the reader to a document in Section VI for detail on specific requirements. These include:

VM-0	Introduction, General Information and Table of Contents
VM-1	Definitions for Terms in Requirements
VM-2	Definitions for Types of Contracts
VM-3	PBR Applicability to Contracts
VM-5	NAIC Model Standard Valuation Law
VM-20	Requirements for Principle-Based Reserves for Life Contracts.
VM-21	PBR Variable Annuity (VACARVM)
VM-22	Requirement for Principle-Based Reserves for Non-Variable Annuity Contracts
VM-25	Health Insurance Reserves Minimum Reserve Requirements

continued on page 10 >>

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VM-26 Credit Life and Disability Reserve Requirements
VM-30 Actuarial Opinion and Memorandum Requirements
VM-31 Reporting and Documentation Requirements for Business Subject to PBR
VM-40 Review Opinion Requirements for a Principle-Based Valuation
VM-50 Experience Reporting Requirements
VM-51 Experience Reporting Formats

Recent Developments

With respect to PBR for life insurance, developments between the September and December NAIC meetings include definition of a test for sensitivity to economic scenarios (formerly the Material Tail Risk Test) and reconstruction of the guidance for determining the valuation mortality assumptions.

The purpose of the test for sensitivity to the economic conditions is to provide the practitioner a safe harbor test to demonstrate a group of policies as qualifying for the stochastic modeling exclusion. This test is under review by LHATF, but all indications are that it will approve the general methodology. The test is performed on a limited number (12) of proposed economic scenarios, one of which is considered baseline, and focuses on a ratio of (A-B)/C where:

The mortality section of VM-20 (Subsection 6) has been updated to include a clarified methodology for arriving at valuation mortality rates.

A = highest scenario reserve amount among the 11;
B = baseline scenario amount; and
C = PV of benefits and expenses, determined on baseline scenario.

A, B and C use prudent estimate assumptions and follow the definition of scenario reserve found in VM-20. Regulators would need to determine a threshold level for policies to qualify for the stochastic modeling exclusion. A group of policies for which there is a clearly defined hedging strategy is viewed by the regulators as a group of policies ineligible for the stochastic modeling exclusion regardless of the type of hedging being used.

The mortality section of VM-20 (Subsection 6) has been updated to include a clarified methodology for arriving at valuation mortality rates. The objective of the rewrite was to provide companies with little or no credible experience a simplistic way to find the appropriate valuation mortality table. A credibility criterion has been introduced. This criterion has yet to be determined, but can be thought of as a threshold credibility level. If the company's credibility falls below the credibility criterion threshold, the company uses its underwriting and risk-classification procedures (through a scoring procedure) to map into a VBT and its corresponding CSO mortality table.

If the company's experience mortality credibility falls above the criterion, the company would use a more complex path to determine the appropriate valuation mortality assumption. This path includes the underwriting scoring procedure, determination of the appropriate VBT industry table and a method for blending the industry table with company experience rates. A margin is added to the blended rates. Finally, the company would select the CSO mortality table that provides a seriatim reserve closest to, but not less than, a seriatim reserve based on the blended rates with margin. $