Article from
Reinsurance News
November 2019
Issue 95

Reinsurance and Principle-Based Reserves—Insights Into Emerging Practices

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Mandatory implementation of life principle-based reserves (PBR) is just around the corner and there is no shortage of work to do, as most products have yet to be moved to PBR.

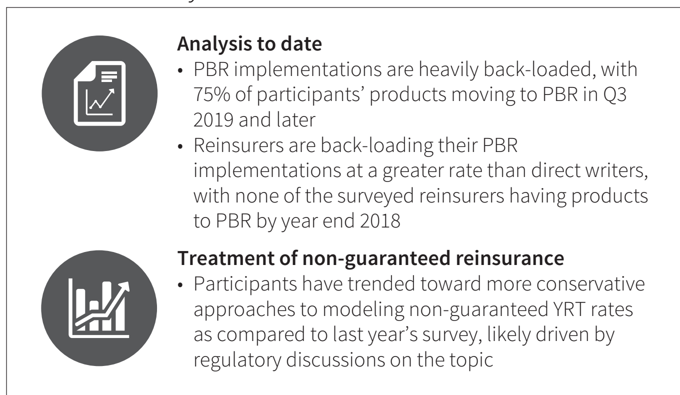
Oliver Wyman recently completed its 2019 PBR survey, with more than 40 participants covering 85 percent of the individual life market, including 23 of the top 25 life writers and five reinsurers.

This article expands on the key survey findings shown in Figure 1, focusing on implementation trends, analysis to date and recent discussions on the treatment of non-guaranteed reinsurance.

PBR IMPLEMENTATIONS ARE HEAVILY BACK-LOADED, PARTICULARLY FOR REINSURERS

Figure 2 (Pg. 27) summarizes actual PBR implementations through 2018 and planned implementations through the remainder of the optional implementation period.

Figure 1
Key Findings from the 2019 Oliver Wyman PBR Emerging Practices Survey



As of year-end 2018, one-third of direct writers and none of the surveyed reinsurers had moved products to PBR. Planned implementations remain low for 2019 and the data collected shows that most products will move to PBR at the very end of the optional phase-in period.

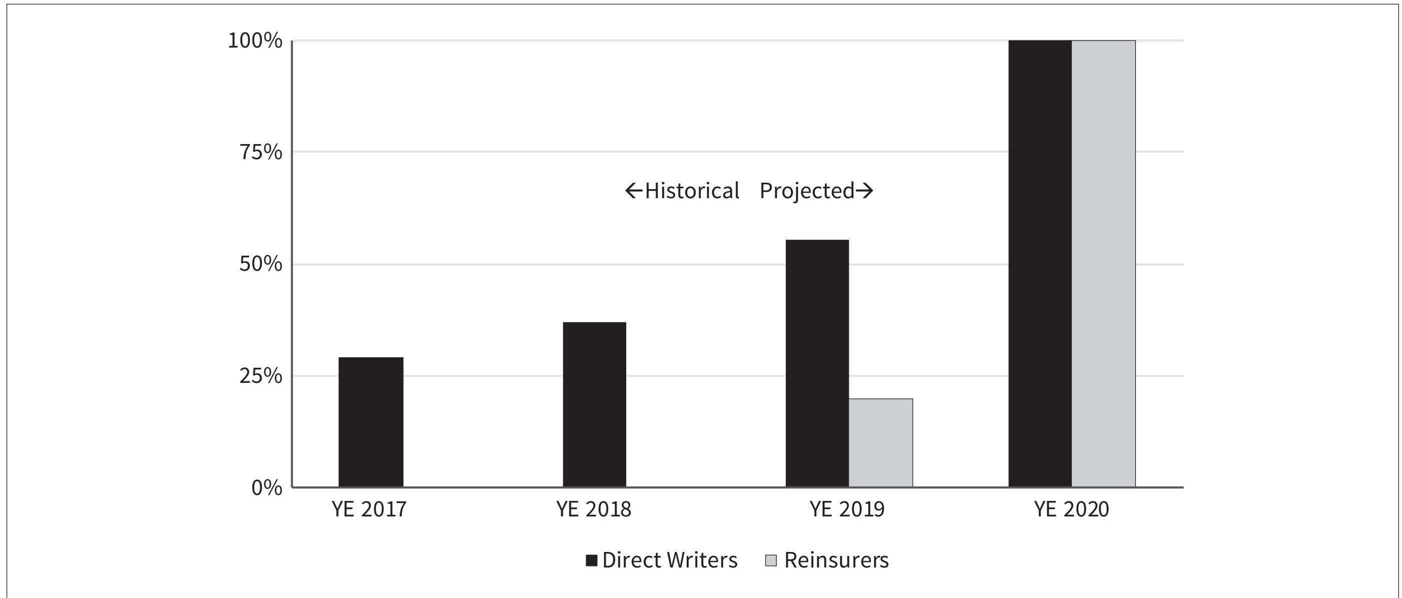
We continue to believe the back-loading of PBR implementation for direct writers is driven by the following:

- Competitive pressures and prevalence of reserve financing solutions for term and, to a lesser extent, ULSG, for which reserve reductions decrease tax leverage
- Resource constraints and the level of effort required to move products to PBR, including additional reporting and disclosure requirements
- Evolving PBR requirements, which have material impacts on profitability

Reinsurers follow an even more back-loaded implementation pattern, with more than 75% of their products planned to move to PBR until 2020. The drivers of delayed implementation are similar for reinsurers as direct writers, but further amplified due to the business in scope for PBR:

- Coinsurance: Primarily term with a high prevalence of reserve financing solutions

Figure 2
Percentage of Participants with Products on PBR by Year End



The percentages were calculated as (number of participants with at least one product in category on PBR) / (total participants), split by Direct Writers and Reinsurers

- Yearly renewable term ("YRT"): Regulatory treatment was being actively discussed with a wide range of potential solutions in-play until an interim solution was finalized in June of 2019

Overall, the continued evolution of PBR requirements is a key driver of delayed implementation. The National Association of Insurance Commissioners (NAIC) Life Actuarial Task Force (LATF) increased the frequency and length of its calls during the first half of 2019 to finish any high-priority changes to PBR requirements for inclusion in the 2020 *Valuation Manual*; it approved 55 changes through June 30, which was formally adopted into PBR requirements at the summer NAIC meeting.

REINSURERS ARE BEHIND BUT MAKING PROGRESS ON THEIR PBR ANALYSIS

Table 1 summarizes the percentage of the life product portfolio for which participants had performed PBR analysis as of last year's and this year's survey.

Reinsurers had analyzed a small portion of their portfolio in 2017, but made considerable progress in 2018.

Table 1
Percentage of Products for Which the Impact of PBR Was Analyzed

Product Type	12/31/2017	12/31/2018
Direct Writers	56%	61%
Reinsurers	11%	48%

THE BROADER RESOURCE LANDSCAPE NEEDS TO BE CONSIDERED

Given that implementations are heavily backloaded, adhering to timelines will be crucial in the final stretch of the optional phase-in period. Direct writers and reinsurers must consider the time it takes to reprice, file and launch their offering, and that there will likely be additional strain on both internal and external resources from regulatory changes taking place simultaneously (e.g., Financial Accounting Standards Board targeted improvements for long duration contracts, variable annuity reform, IFRS updates). Stakeholders need to be well informed of any required work and expected timelines for remaining implementations.

TREATMENT OF NON-GUARANTEED REINSURANCE DEVELOPMENTS

The treatment of YRT (Yearly Renewable Term) reinsurance was extensively evaluated in Oliver Wyman's 2019 survey. Compared to 2018, the industry was slightly more conservative in its approach to modeling non-guaranteed YRT rates, but more aggressive approaches are still prevalent (e.g., 30 percent assumed immediate increases to YRT rates).

In June 2019, LATF adopted an amendment to VM-20 that sets the reinsurance credit to one-half c_x in response to the wide variation in modeling of non-guaranteed YRT reinsurance arrangements. Reference to the amendment proposal form and applicability are summarized in Table 2 (Pg. 28).

Table 2
Details on June 2019 LATF Decision on Non-Guaranteed Reinsurance

APF*	2019-39
Applicability	Business issued in 2020 and beyond
Modeling of reinsurance	Not required
Reserve credit (or assumed reserve)	½ c_x
Solution	Temporary

* Amendment Proposal Form. The text of this can be found at *https://www.naic.org/documents/index-industry_latf_apf_2019-39.docx*.

Regulators agreed that this solution is only temporary and not principles-based, and a field test is underway with a goal of determining a permanent solution in time for inclusion in the 2021 *Valuation Manual*. The field test timeline is ambitious and overlapping with year-end financial reporting, therefore third-party consultants are being considered.

Mandatory PBR implementation is upon us, and many products remain to be moved to PBR by Jan. 1, 2020.

Before the LATF decision, a third of the surveyed companies anticipated making changes to reinsurance agreements as a result of PBR. Of those, half were looking to guarantee the current scale for a period of time, and a third were looking to reduce the guaranteed maximum rates. Possible reasons for these changes include:

- Supporting modeling approaches
- Taking judgment out of modeling decisions
- Reducing or eliminating regulatory risk in light of anticipated changes to requirements

As the recent temporary prescription on non-guaranteed reinsurance sets a precedent of regulatory intervention in which significant discretion existed, actuaries gain to understand areas where their practices are less conservative relative to their peers.

THE ROAD AHEAD

Mandatory PBR implementation is upon us, and many products remain to be moved to PBR by Jan. 1, 2020; particularly for Reinsurers. As stated, we believe that the back-loading is largely conscious, but that many implementations are effectively behind, requiring additional focus and resources to reach the finish line.

As evidenced by the recent discussion on non-guaranteed reinsurance, PBR continues to evolve. We expect the discussion on non-guaranteed reinsurance reserve continue as potential long-term solutions are evaluated.

As everything comes together, it will be important to skillfully manage all impacted areas—product, modeling, pricing, assumption setting—and to build in optionality that allows swift reaction to potential changes in regulations. ■

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