Session 23PD: PBR for the Procrastinator – What you should be doing NOW even if you decided to wait

Moderator:

Presenters:
Woodrow Michael Crouch FSA,MAAA
Kevin Piotrowski FSA,MAAA,CERA
Benjamin Morris Slutsker FSA,MAAA
Session 23: PBR for the procrastinator, what you should be doing NOW, even if you decide to delay reporting until 2020

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Kevin Piotrowski, FSA, CERA, MAAA
Manager, Ernst & Young LLP

Ben Slutsker, FSA, MAAA
CVP & Actuary, New York Life

Woodrow Crouch, FSA, MAAA
AVP & Appointed Actuary, Amica Life Insurance Company
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Kevin Piotrowski, FSA, CERA, MAAA
Manager, Insurance and Actuarial Advisory Services, Ernst & Young LLP

Mr. Piotrowski is a Manager in the Insurance and Actuarial Advisory Services practice of Ernst & Young LLP’s Financial Services Office. He is based in New York and has 7+ years of consulting experience. He serves as an advisor to large insurance companies and is focused on Financial Reporting.

Kevin focuses his time on various aspects of insurance including assumption setting, valuation, reinsurance reporting and capital management. Additionally he has been involved in large scale model validation projects as well as assisting companies to transform their actuarial systems and processes (Actuarial Transformation). Recently, Mr. Piotrowski has focused his efforts on Principle Based Reserves - managing review of both AG-48 and VM-20 implementations at various companies. He has written articles around PBR implementation and is involved in the SOA’s effort to provide more depth/breadth around Principle Based Reserves.

Kevin is a Fellow of the Society of Actuaries (FSA), a Chartered Enterprise Risk Analyst (CERA) and a Member of the American Academy of Actuaries (MAAA)


Ben is a Fellow of the Society of Actuaries (FSA) and a Member of the American Academy of Actuaries (MAAA).
Woodrow Crouch is a AVP & Appointed Actuary for Amica Life Insurance Company and is responsible for the implementation of Principles-Based Reserving at Amica. Prior to be named the Appointed Actuary, Woodrow was the head of Valuation and Financial Projections.

Woodrow has more than 20 years of Life insurance experience. He began his career at Boston Mutual were he held positions in Individual Product Pricing, Valuation and Cash Flow Testing. He then joined John Hancock were he lead a CALM modeling team (calculating Canadian Principal Based Reserves). Woodrow then joined New York Life were he preformed UL Pricing and Inforce Management, Asset Liability Management, Cash Flow Testing, Embedded Value Analysis and helped develop a stochastic pricing framework.

Woodrow is a Fellow of the Society of Actuaries (FSA) and a Member of the American Academy of Actuaries (MAAA).
What will you learn today?

- How to prepare for PBR
- Transition Plan
- Future Vision
- Challenges
  - Small Company
  - Large Company
Polling question

Will your company re-design or re-price a product in 2017 under PBR?

1. Re-price a current product but no change to the product design
2. Re-price a current product and make some modifications to product features or riders
3. Develop a brand new PBR product
4. Not planning to re-design or re-price a product in 2017
5. Unsure, even if we do re-design or re-price a product, we will not start selling it in 2017
Polling question

If you answered no to the previous questions, what is the reason?

1. Waiting for more developed industry practices as it relates to the Valuation Manual
2. Waiting for IRS guidance on tax laws
3. Not enough resources
4. Not a high priority for senior management (other competing tasks)
5. Plan on taking small company exemption
Industry readiness

**PBR readiness assessment (SOA)**

- Plan to value policies under VM-20 in 2017
- Company elects 3-year transition period
- Company meets small company exemption
- Unsure of tax reserve impact
- No products fall under VM-20
- Value only under AG-48


**PBR Pilot Project Company Survey**

- **Three** indicated they would value products issued in 2017 under PBR
- **One** indicated they might value products issued in 2017 under PBR depending on the outcome of what Tax Reserve would be allowed under PBR by Treasury
- **Seven** indicated they would not value any business issued in 2017 under PBR

*From: PBR Company Pilot Project Final Report (January 2017)*

**EY survey of 25 companies:**

"How prepared are you to adopt PBR?"

- 1 = have not started
- 5 = ready to adopt today

*From: EY Key Issues Survey 2016*

**EY survey of PBR implementation readiness**

- Qualify for exemption
- 2017
- Transition over time
- Delay to 2020

*From: EY PBR Landscape Survey (June 2017)*
Polling question

If you are not issuing or re-pricing a product in 2017 (for one of the reasons listed earlier) do you have a plan in place?

1. Yes – full roadmap, detailed work plan, impact study and product release calendar
2. Yes – high level roadmap
3. No – not that far along in the process yet
4. No – don’t find the planning exercise valuable
5. No – planning on taking the small company exemption
The above graphic defines the key milestones when implementing PBR. The first step is creating a transition plan and roadmap. This step is crucial as it will define the project in terms of scope, resources, product calendar and time commitment.

The following describes certain aspects that are key to the roadmap and transition plan.
The future vision of a company needs to be defined for long term success. It is the first step in the process to transition to PBR (or really any transition) and should be focused at a high level. This should be based on a strong 3, 5, and 10 year plan as to where the company wants to be in the insurance space (both strategically and competitively) – some examples:

- Will certain blocks be closed to new business in the future?
- Are there aggressive sales/marketing goals for certain products?
- What is the appetite for M&A?
- Will a small company stay a small company?

The future vision might also include technological considerations:

- Is current actuarial software capable of handling the PBR reporting requirements (for pricing, valuation and forecasting/projections)?
- Is a robust infrastructure in place and able to support the PBR modeling and reporting processes.

This is the precursor to the next few steps (education, key early decisions and evaluation of downstream impacts).
Polling question

How familiar are you with the requirements of VM-20, VM-31, VM-G and VM-50/51?

1. I can teach at the next PBR boot camp
2. Very familiar
3. Somewhat familiar
4. I know enough to get by
5. Not at all – when I hear PBR I still think of beer from Milwaukee
There are tons of sources of information around PBR – from technical learnings on reserve calculations to more high level reviews of product impacts. They vary in terms of form and cost, but all have the same goal (advancing knowledge of PBR).

More detail on these can be found in the appendix.
Key early decisions

Business decisions
- Product design/market
- Resources/company structure
- Financial planning and capital management
- External stakeholders

Implementation decisions
- When to implement
- Which products
- How to model
- Tax considerations
- Asset considerations
- Governance/Control structure
VM-20 impact study

• Once key decisions are made regarding PBR implementation, it is important for companies to perform **their own impact studies** testing these decisions
• These impact studies will relate to reserve changes, assumptions, product mix, product offering, VM-20 applicability and exclusion tests
• Over the past several years, the SOA has commissioned some impact studies from various consultants to try to bring an industry perspective to how VM-20 will impact the life insurance industry
To ensure buy-in from management and the company as a whole, companies should have early discussions with regulators, rating agencies, the board of directors, and other key stakeholders. Starting with the chief actuary, encouraging buy-in from the top down can influence company culture, individual employee morale, and the success of the project. At the same time, employees need to work together toward one goal in a bottom-up approach. As new regulations become effective, the competitive landscape will change – so it is important for all companies to align their current strategy with their company’s long-term vision by setting up a team structure that supports PBR implementation.

Example of team structure:
Roadmap and detailed project plan discussion

- Develop both a roadmap and detailed project plan for PBR implementation
- Roadmap: graphical, high level overview of the project’s goals and deliverables presented on a timeline from start to finish
- Project plan: more detailed description of how the project is executed, monitored and controlled
- Examples of roadmaps and project plans are shown below:
Longer term challenges

<table>
<thead>
<tr>
<th>Product Development / Pricing</th>
<th>Assumption Setting (valuation)</th>
<th>Valuation</th>
<th>Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Product mix and new design</td>
<td>• Assumptions related to valuation (refinement)</td>
<td>• Stat/Tax, Gross/Net of Reinsurance</td>
<td>• Attribution analyses/explaining results</td>
</tr>
<tr>
<td>• Review of current mix</td>
<td>• Coordination between pricing and valuation assumptions</td>
<td>• Post valuation processing</td>
<td>• Experience tracking (VM-50/51)</td>
</tr>
<tr>
<td>• Reinsurance/hedging</td>
<td></td>
<td>• Reserve levels and volatility by product</td>
<td>• VM-31</td>
</tr>
</tbody>
</table>

Modeling
- Can models handle stochastic reserves
- Can models handle projection capabilities
- Modeling all three reserve components

Assumption Setting (pricing)
- Assumptions related to pricing (assets and liabilities)
- Assumption governance

Governance & Controls
Kevin Piotrowski
Manager – Insurance and Actuarial Advisory
Ernst and Young
kevin.piotrowski@ey.com
PBR for the Procrastinator: Challenges for Large Companies

Ben Slutsker
CVP & Actuary
New York Life Insurance Company
August 28, 2017
What can large companies do to prepare for late PBR implementation?

**PBR Project Planning**

**PBR Internal Expertise**

**PBR Implementation**

- **Set Assumptions**
  - Assumption control framework
  - Assumption setting process
  - Mortality, adjustments, margins

- **Build Modeling**
  - Models across functions
  - ALM and stochastic functionality
  - Projected scenario generation

- **Establish Governance**
  - VM-G
  - Controls and validation
  - Interpretation of guidance

- **Explore Valuation**
  - Financial reporting preparation
  - Annual unlocking impacts
  - VM-31
Polling Question

Which team contains the PBR expertise within your company?

a) Central PBR team  
b) Actuarial regulatory team  
c) Across many actuarial teams – same structure teams as before  
d) Across many actuarial teams – new team structure  
e) Do not know
Assumptions – Framework & Specific Issues

• Governance Framework
  1) Validating and applying assumptions
  2) Approving assumptions

• Process Flow
  1) Sharing across pricing, valuation, and inforce projections
  2) Consistency across different products and frameworks

• Modifications to Underwriting
  1) Any new underwriting being introduced?
  2) Forecasting credibility / sufficient data period
  3) Aggregate with prior experience? Additional margin?
  4) Accelerated underwriting: mortality tables, margins, grouping

• Setting Margins
  1) Non-mortality margins
  2) Company margin policy
  3) Re-pricing products
## Assumptions - Consistency across actuarial frameworks

<table>
<thead>
<tr>
<th>Assumption Type</th>
<th>Applicable Products</th>
<th>Assumption Methodology</th>
<th>Assumption Source</th>
</tr>
</thead>
</table>
| PBR Prudent Estimate            | Primarily Term, ULSG, VULSG, IUL | **Best Estimate + PBR Margins** | -Company experience  
-Select & disclose margins  
-Prescribed assets/mortality |
| Company Best Estimate           | All products                 | **Best Estimate**               | -Company experience |
| GAAP: FAS 60 Reserves & DAC     | Primarily Term and short duration contracts | **Best Estimate + PAD** | -Company experience  
-Select & disclose PADs  
-Locked in |
| GAAP: Loss Recognition Testing & FAS 97 / 120 DAC | Primarily Whole Life, UL, VUL, ULSG, IUL | **Best Estimate** | -Company experience |
| Cash Flow Testing               | All products                 | **Best Estimate + CFT Margins** | -Company experience  
-Select & disclose margins  
-Margins for PBR may not be the same as CFT |
• Start scoping out prescribed asset assumption requirements
  o Starting asset scaling
  o Reinvestment strategy guardrail

• Modeling process – think about handoffs

• Diversification for PBR calculation
  o Defining aggregation
  o Rider treatment

• Prepare scenario generation
  o Scenarios on-the-fly within platform
  o Academy excel tool

• Do you need stochastic on stochastic?

Stochastic on Stochastic Pricing
Governance - Overview

• Know how to fulfill VM-G requirements
  • Select qualified actuary / actuaries
  • How to inform senior management and board of directors
  • VM-G compliance in 2017 for variable annuities w/ guarantees

• Is there a framework set up for internal controls?
  • How are assumptions loaded into model, locked down, validated?
  • Review techniques and layers of defense? Who owns review?

• Ambiguity in Guidance...
  • Awareness of VM amendment proposals
  • Make a list of ambiguous items in VM-20
    ➢ Work through issues over years leading up to implementation
Governance – Preparing for Ambiguity in Guidance

- Mortality Open Issues
  - Industry tables for SI, GI, AUW
  - Tools for industry table mapping
  - Mortality margins for underwriting adjustments
  - Mortality credibility calculation and aggregation level

- Valuation Open Issues
  - Term rider reserve calculation? → Combined or separate from base policy?
  - NPR for VUL and IUL w/ secondary guarantees
  - Tax reserves for pricing and valuation?

- Additional Open Issues
  - NPR reserve for Term products with multiple level premium periods?
  - Grouping products, modeling segmentation, and portfolio segmentation
  - Hold a margin on reinsurance cash flows within PBR calculation?
Polling Question

What method does your company expect to use for holding additional margins on YRT reinsurance for PBR?

a) No additional margin on reinsurance cash flows
b) Attempt to model X% percent premium increase or recapture at future point
c) Increase reinsurance premiums by mortality margins
d) Floor reinsurance premium rates at experience mortality or take max of direct and net reserves
e) Other than described above or no idea
Valuation – Reporting Process Flow

- **Roles and Responsibilities**
  - Who is running the PBR valuation model (i.e. production team)?
  - NPR and modeled reserves in separate models? If so, who will combine these?
  - Who is responsible for reviewing the final reserve calculation before booking?
  - Who is responsible for the VM-31 report?
  - Who is responsible for ensuring the intended assumptions are being used?

- **Timing**
  - Timing between calculation and target reporting? Asset timing?
  - Conduct unlocking analysis prior to reporting period?
  - Use three month window allowed for VM-20?
  - Demonstrate 2.G simplification techniques on off-reporting periods?
Polling Question

Who do you expect to be your company’s production team that will be running the PBR valuation models?

a) Our current valuation team
b) Our ALM / inforce projection team
c) A specifically designated, centralized production team that is already in place
d) A specifically designated, centralized production team that is new
e) Have no idea
Valuation – Blue Book, VM-31, Unlocking

• Prepare for changes to Statutory financial statements under VM-20
  • Additional VM-20 Reserve Supplements – know how to fill out
  • Prepare for blue book exhibit modifications
  • Select a method for reserve credit allocation among treaties

• Prepare for the VM-31 PBR Actuarial Report documentation requirements
  • Inventory of all assumptions, experience studies, rationale
  • Identify current documentation to leverage
  • Embed new documentation for VM-31 within normal processes

• Prepare for Statutory reserve assumption unlocking on inforce business
  • Current baseline CRVM is more rules-based
  • PBR requires unlocking modeled reserves on recurring basis
  • Governance, analysis, surplus volatility associated with unlocking
Ben Slutsker
CVP & Actuary
New York Life Insurance Company
benjamin_slutsker@newyorklife.com
PBR for the Procrastinator:
Challenges for Small Companies

Woodrow Crouch FSA, MAAA
Assistant Vice President and Appointed Actuary
Amica Life Insurance Company
August 28, 2017
Procrastination

- “Why do tomorrow? What you can do the day after tomorrow?”
  - Mark Twain

- Implementing PBR is a major endeavor that is best done in stages. Early planning can make implementation less painful.
What can small companies do to prepare for late PBR implementation?

**Set Assumptions**
- Assumption Documentation
- Assumption Committee
- Mortality margin/credibility issues

**Build Modeling**
- Lack of Internal Expertise
- Model Conversions

**Establish Governance**
- VM-G
- Educate Senior Management
- Peer Review

**Explore Valuation**
- Reporting Lags
- Systems Integration
- VM-31
Company Wide Exemption

• **Premium threshold**: The company’s ordinary life premiums must be less than $300M for the legal entity and less than $600M for the associated group.

• **Risk-Based Capital (RBC) threshold**: The company’s RBC must be at least 450%, unless ordinary life premium is under 50M. The insurance commissioner can waive this requirement for 1 year.

• **ULSGs**: There can be no material Universal Life with secondary guaranty business in force, issued after 1/1/2020.
Polling Questions

Does you company qualify for the exemption?

a) No
b) Yes, but performing PBR
c) Yes and not performing PBR
d) Do not know yet
Should I take the Small Company Exemption?

Considerations:

• Product Mix – Lots of Term? Any ULSG?
• Credibility – Do I have credible assumptions?
• Tax Impact – will tax impacts offset the positive statutory accounting changes?
• Will the company continue to meet the exemption requirements over time?
Assumption Challenges

• Building a formal assumption setting framework
  • Create a assumption setting committee that reviews and approves assumptions.
  • The committee should document their approval.

• Margins and Credibility
  • Lack of credibility especially for the mortality assumption needs to be addressed.
  • May need to rely on reinsurer data to gain sufficient credibility to keep margins reasonable.
Polling Question

• Do you currently have a formal assumption setting committee?
  a) No - Have other assumption governance process
  b) No - Do not have formal assumption governance process
  c) Yes
Modeling Challenges

• Small Companies may not have extensive in house modeling expertise. May need to staff up for PBR.
• Building PBR models should be started early.
• Does you current model platform support PBR? If not you will need to convert to a different platform.
Polling Question

Have you converted a new actuarial software platform to accommodate PBR?

a) Yes
b) No, but plan to convert to a new platform
c) No
d) Undecided
Governance Challenges

• This will be a large hurdle for many small life insurers, where governance is largely non-existent.
• Need to start educating senior management.
• Need to start adding controls to actuarial models.
• Need to get management used to signing additional disclosures.
Valuation Challenges

• Reporting Lags – may grow
• Incorporating the NPR floor into the model calculated reserve
• Preparing the VM-31 report
  • Start preparing this documentation now!
Woody Crouch
AVP & Appointed Actuary
Amica Life Insurance Company
wcrouch@amica.com
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Appendix – education references
• **PBA Perspectives** from the American Academy of Actuaries is designed to keep insurers up to date on activities surrounding the implementation of PBR for life insurance

<table>
<thead>
<tr>
<th>NAIC meeting activity</th>
<th>PBR progress</th>
<th>Upcoming</th>
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<tbody>
<tr>
<td>• At the NAIC’s 2017 Spring meeting, LATF adopted:</td>
<td>• A bill was introduced in the New York Senate in May (however this has been since delayed) that would enable life insurers to employ the VM for PBR, and similar legislation was pending in Massachusetts. In March, the governor of Wyoming signed legislation that allows insurers to start using the VM.</td>
<td><strong>PBR boot camp for regulators</strong></td>
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<tr>
<td>• <strong>VM-22 Subgroup Report</strong> (pgs.111-136) that provides the methodology for determining valuation interest rates for income annuities.</td>
<td>• To date, 47 states representing more than 87 percent of U.S. direct written premiums have adopted a new Standard Valuation Law (SVL) to enact PBR. This exceeds the threshold of 42 states and territories with 75 percent of written premium set by the NAIC for implementation of the VM, and life insurers in most states can start utilizing PBR on Jan. 1, 2017.</td>
<td>• The Life Practice Council is planning a regulator-only PBR Boot Camp in Las Vegas on Sept. 11–13. More details will be available shortly on the Academy’s website.</td>
</tr>
<tr>
<td>• <strong>Four amendments</strong> (pages 164-174) for non-substantive changes to the VM, including moving the tables from VM-20 Appendix 2 to the Related Documents tab on the task force web page.</td>
<td>• States Not Yet Adopting New SVL (percent of direct written premium as of June 20, 2017)</td>
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<tr>
<td>• Exposures:</td>
<td>• Alaska - .16% *</td>
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<tr>
<td>• the American Academy of Actuaries Life Experience Committee and Society of Actuaries’ Preferred Mortality Oversight Group’s “2017 Guaranteed Issue Mortality Tables” until June 9.</td>
<td>• Massachusetts – 3.27%*</td>
<td></td>
</tr>
<tr>
<td>• <strong>Proposed edits</strong> to VM-30 to clarify the documentation requirements for mortality assumptions until April 24.</td>
<td>• New York – 9.20%*</td>
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<tr>
<td>• Seven amendments for substantive changes to the VM for a 21-day comment period until May 1, including 2017-8, 2017-9, 2017-12, 2017-13, 2017-14, 2017-19, 2017-22.</td>
<td>* Percentage of U.S. life underwriting</td>
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<tr>
<td>• <strong>Modifications</strong> to VM-51 for a 21-day comment period until May 1.</td>
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### Education

**Life practice council updates from PBA Perspectives**

- **Comments on PBR ASOP exposure draft**
  - The PBR Governance Work Group submitted comments in May to the Actuarial Standards Board (ASB) on the exposure draft for a new ASOP, *Principle-Based Reserves for Life Products*.

- **Comments on VM-20**
  - The Life Reserves Work Group submitted comments in May on two LATF proposed amendments to VM-20—a [comment letter](#) related to additional definitions and another [comment letter](#) related to proposed changes to Section 2G.

- **Report on guaranteed issue mortality tables**
  - The Life Experience Committee and SOA’s Guaranteed Issue/Simplified Issue/Preneed Working Group gave a report to LATF in April on 2017 guaranteed issue mortality tables, including spreadsheets with a blended mortality table, a male mortality table, and a female mortality table.

- **PBR under VM-20 practice note**
  - The Life Principle-Based Approach Practice Note Work Group released the [practice note](#), *Life Principle-Based Reserves Under VM-20*, in May to assist actuaries with the implementation of the PBR valuation approach adopted by the NAIC as detailed in the Requirements for Principle-Based Reserves for Life Products—VM-20.

- **Model governance practice note**
  - The PBR Model Governance Practice Note Work Group released a new [practice note](#) in April to provide additional information for practicing life actuaries seeking to better understand models, model risks, model governance, and related issues, as they implement PBR.

- **APF on VM-20 language on policy loans and separate account assets**
  - The Life Reserves Work Group submitted an [amendment proposal form](#) in May to LATF regarding the VM-20 wording on modeling of policy loans and separate account assets.

- **Simplified issue, guaranteed issue, and accelerated underwriting presentation**
  - Mary Bahna-Nolan, chairperson of the Academy’s Life Experience Committee and SOA Preferred Mortality Oversight Group, presented updates to LATF in April on its work on [guaranteed issue and preneed mortality tables](#) and [simplified issue and accelerated underwriting mortality](#) under VM-20.

- **Post-NAIC webinars**
  - The Life Practice Council held post-NAIC webinars in April and January to give updates on the NAIC’s Spring 2017 and Fall 2016 national meetings that focused on LATF activities, and actions by other groups regarding PBR and other life topics.

- **Academy launches “PBR in Practice” resource**
  - The Academy in January launched “PBR in Practice,” a web page that assembles materials to assist actuaries and regulators as actuaries in most states move into the implementation phase of PBR for life insurance.