AMERICAN ACADEMY of ACTUARIES

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August 15, 2017

Ms. Susan Bernard
Chair, Financial Examiners Handbook (E) Technical Group
National Association of Insurance Commissioners

Dear Ms. Bernard,

The Principle-Based Reserving Review Procedures Work Group of the American Academy of Actuaries[1] appreciates the opportunity to provide comments on the June 29, 2017, exposure of proposed changes to the Financial Condition Examiners Handbook.

In general, the work group believes the exposure draft represents a significant improvement over the current framework by including a new section for Life Insurance Reserves Review and additional considerations in the Corporate Governance and Life Exam Repository for Principle-Based Reserve (PBR) Revisions. The work group does, however, recommend some substantive changes detailed below.

Recommended Changes to the Exposure

1.) Section III.E.1.6 and III.E.6

The work group suggests the following edits to clarify the description of which business requires actuarial involvement because "significant uncertainty in the appropriateness and/or amount of actuarial reserves" may apply to health insurers, credit insurers and, in some cases, term life insurers not subject to PBR.

> *Section III.E.1 Decision to Use the Work of a Specialist*
>
> *In certain situations, an examination requires the use of a specialist to effectively examine an insurer. These situations include the following:*
>
> *a. Life and Health company examinations where the company has a substantial amount of interest-sensitive business,* ***has a substantial amount of the actuarial reserves that entail significant judgment,*** *or the company has a substantial amount of business subject to PBR calculations or PBR exclusion tests require the involvement of a credentialed actuary to perform an evaluation of reserves.* (emphasis added)

[1] The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

b. Property & Casualty company examinations where the company has a substantial amount of long-tail lines of business require the involvement of a credentialed actuary to perform an evaluation of loss reserves.

Section III.E.6: Actuarial Specialist

As previously noted, the involvement of a credentialed actuary is required on all examinations of ***property/casualty insurers with a substantial amount of long-tail lines of business and life and health insurers with a substantial amount of interest-sensitive business, a substantial amount of actuarial reserves that entail significant judgment, or when the company has a substantial amount of business subject to principle-based reserve (PBR) calculations or subject to PBR exclusion tests…*** (emphasis added)

2.) Section VI.B. Second paragraph

We suggest changing "The mortality rate assumptions are substantially higher…" to "The mortality assumptions are higher…" because when X-factors are applied or super-preferred underwriting classes are used as permitted, the mortality assumptions may be minimally higher than underwriting experience.

3.) Section VI.B. Third paragraph

We suggest significant changes to the third paragraph to more accurately describe the commonly used formulaic reserving methods for statutory life insurance reserves. Our recommended wording for the revision of paragraph is provided below for your consideration:

There are three general valuation methods under a formula based valuation methodology commonly used to value statutory life reserves. Each of these methods assigns reserves equal to the present value of future benefits less the present value of future premiums. The methods differ in how expenses are recognized. The net level premium method (NLP) uses net premiums and does not recognize any expenses. Therefore, this method often results in the most conservative, or highest, life reserve valuation of the three methods. The full preliminary term method (FPT) recognizes for an expense allowance in the first year. Under FPT the reserves in the first year are computed as if the policy were a one-year term insurance policy. After the first year, reserves are computed using the NLP method with the policy assumed to be issued at the beginning of its second year. The net premiums after the first year under the FPT are higher than the NLP premiums. The Commissioners Reserve Valuation Method (CRVM) is a modified blend of the full preliminary term and net level premium methods. It allows the first year's net premium as an expense allowance and then spreads that expense allowance over the policy's coverage period or 19 years, whichever is less. This method allows for a lower life reserve valuation than the net level premium method in the earlier years of the policy term. The CRVM results in a reserve valuation which grades from $0 in the first year to the NLP over a period of up to 20 years.

4.) Section VI.B. (New Section) Credit Life Reserves

We suggest adding a section on "Credit Life Reserves" between sections 3 (Industrial Life Reserves) and 4 (Life Reserves Related to Riders) on page 12. Credit insurance is a distinct line of business in the annual statement and has a separate section in the Valuation Manual. Its inclusion is recommended for completeness.

The following language is offered for your consideration:

> Credit life insurance policies are designed to discharge a debt upon the debtor's death. They are usually funded as a single premium. Reserves requirements vary among the states. Key considerations include claims reserves and policy reserves based on some state-specified combination of mortality reserves, unearned premium reserves, and potential refunds. Credit Life and Disability Reserves are addressed in Valuation Manual (VM)-26.

5.) Section VI-C

We suggest the second paragraph be moved to follow the third paragraph for clarity. The reserve liability is described in the paragraph that starts with "The principle-based valuation methodology…" The stochastic reserve (SR) is one of the components used to determine the reserve liability under PBR. We recommend changing the first sentence of the paragraph that describes the SR from "The reserve liability…" to "The stochastic reserve…"

6.) Section VI-E. Actuarial Oversight and Internal Controls

We suggest the technical group consider including the responsibilities of the qualified actuaries as described in VM-G. The Valuation Manual has recommendations for the board and management, and includes governance requirements for the qualified actuaries. The qualified actuaries' adherence to these requirements should be included in the governance portion of any examination.

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Should you have questions regarding these suggestions, please contact Ian Trepanier, the Academy's life policy analyst, at trepanier@actuary.org.

Sincerely,

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Chairperson, Principle-Based Reserving Review Procedures Work Group
American Academy of Actuaries