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AMERICAN ACADEMY *of* ACTUARIES

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March 19, 2019

Mr. Michael Boerner  
Chair, Life Actuarial (A) Task Force (LATF)  
National Association of Insurance Commissioners

Dear Mike,

Principle-based reserving (PBR) has been effective since 2017. Twenty-three companies submitted Valuation Manual- (VM)-31 PBR Actuarial Reports for 2017, and these were reviewed by the Valuation Analysis Working Group (VAWG). As you know, LATF has exposed and discussed amendments to the Valuation Manual in response to concerns raised by that review. As LATF contemplates further updates to the valuation manual for individual life insurance products, on behalf of the Life Practice Council of the American Academy of Actuaries<sup>1</sup>, I would like to take this opportunity to express concern over the recent number of non-substantive and prescriptive updates to VM-20 and VM-31. Let me reiterate some of the reasons that principle-based reserving (PBR) was deemed a better approach than a one-size-fits all, rule-based valuation method.

PBR “allows an insurer to reflect its own unique experience and risks in calculating reserves. PBR utilizes simulation models to estimate the level of reserves needed to cover future claims over many possible or potential future economic scenarios. This type of model requires a recalculation of the reserves held by an insurer on a regular basis based on updated company data and economic conditions. PBR will produce reserves more in line with a company’s actual risk profile; that is, taking into account the relative age, health and other factors of those people it insures, as well as the overall soundness of the company’s investments and financial position.”<sup>2</sup>

It was hoped that moving from prescriptive, formulaic reserves to PBR would facilitate and encourage product innovation while simultaneously ensuring that companies would hold prudent reserves to match the specific risks being insured. To that end, VM-20 was written to allow company actuaries reasonable scope for professional judgment in determining appropriate assumptions, methods, and models in order to most accurately reflect the features of the

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<sup>1</sup> The American Academy of Actuaries is a 19,500-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.

<sup>2</sup> American Academy of Actuaries; “Principle-Based Reserving: A New Way to Insure for Life”; Essential Elements; June 2016.

particular policies being valued and the management practices of the specific company. The actuary has a responsibility to exercise judgment in a manner consistent with actuarial standards of practice and must also document and disclose the assumptions and decisions used to determine an appropriately conservative statutory reserve.

Likewise, VM-31 was written so that the PBR Actuarial Report would help regulators understand both the business (policies) being valued and how company executives think about and manage that business. Sections of VM-31 that require discussion of management practices are meant to provide this understanding, and phrases like “explanation of,” “rationale for.” and “description of” are used for that purpose.

The PBR report should be a tool for discussion between regulator and company management. It is to be expected that actuaries at different companies will have differing methods, differing approaches, and different words to relate the process (assumptions, methods, and models) used to determine the PBR reserve.

The American Academy of Actuaries Life Practice Council (LPC) has supported a principle-based approach as a way to right-size reserves for current products and provide flexibility for innovative products being developed at well-governed companies. We believe an aggregate margin is preferable to individual margins. Toward that end, the LPC worked with regulators and interested stakeholders to develop a model law that enabled a new valuation manual, and VM-20 in particular, that provides actuaries with a reserve methodology allowing professional judgment to be used for many assumptions, methods, and models. VM-20 reserves are much closer to an actuarial view of appropriate statutory reserves than the formulaic reserves under the prior valuation laws. VM-31 provides the means to explain the decisions and judgments used to set reserves.

As LATF contemplates updates to either VM-20 or VM-31 based on review of reports from companies adopting VM-20 modeled reserve methods prior to 2020, we encourage LATF to continue to provide guidance on how to apply the principles underlying PBR, rather than concluding at this early stage of PBR that what is needed is stronger prescription of assumptions, methods, or models. We are concerned with the number and tone of many amendment proposal forms (APFs) being considered. Many of the 2019 APFs would narrow the Appointed Actuary’s range of decisions through more prescription of assumptions and mandated documentation and disclosure. We support changes that improve the readability and content of PBR reports, but do not support changes that move valuation back to a more rigid approach. The goal of PBR was the modernization of valuation methods to better capture the dynamic features contained in most life insurance policies sold today. This flexibility is needed to allow innovation in product design to meet the needs of tomorrow’s consumers.

As actuaries become more comfortable with both preparing and reviewing PBR reserves and PBR reports, it is our expectation that practices and processes can still evolve very naturally, through guidance, in a manner that meets the original goals of PBR and provides important benefits to consumers, companies, and regulators.

Sincerely,

Dave Neve, MAAA, FSA  
Chairperson, Life Practice Council  
American Academy of Actuaries