

Modernization In Insurance Regulation



Larry J. Bruning FSA, MAAA

Chief Actuary

Kansas Insurance Department

lbruning@ksinsurance.org





History of Valuation

- 1858 Massachusetts Legislation
- Commissioner to Calculate Reserves on all policies of all licensed Companies
- Actuary Elizur Wright Appointed Commissioner
- Wright selected Net Level Premium Reserve Method and Combined Experience (1843 British) Mortality Table and 4% Interest Rate
- Controversial Decision of Immense Importance





Valuation In 2006

- Commissioner to Calculate or Cause a Valuation to be made of all Policies of all Licensed Companies
- Commissioner's Reserve Valuation Method and 2001 CSO Mortality Table with 4% Interest Rate
- 1990's Asset Adequacy Analysis Required





Valuation Methodology

- Virtually Unchanged for 147 Years
- One Size Fits All Companies
- Does not address all Insurance Risks
- Reserve too Conservative for Some Companies and not Adequate for Other Companies





Current Reserve Methodology

- Prescribed Formulas (CRVM, CARVM)
- Prescribed Mortality Tables
- Prescribed Interest Rate
- Prescribed CSV Floor (Aggregate)
- Prescribed Asset Adequacy Testing





Calculation Methodology

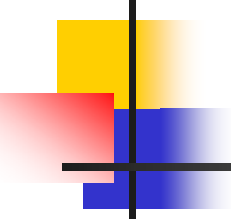
- Current Valuation Framework –

A company's capital and reserve requirement is a function of prescribed regulatory formulas using industry based parameters.

- Principles-Based Valuation Framework –

A company's capital and reserve requirement will be a function of that company's risk profile and risk management processes.





Definition of a Principles-Based Approach

- Captures all material risks.
- Utilizes risk analysis and risk management techniques.
- Incorporates assumptions and methods that are consistent with a company's overall risk assessment process.
- Permits the use of company experience, as credible for risks over which the company has some degree of control or influence.
- Recognizes the solvency objective of statutory reporting.

Reference full text of principles at www.actuary.org/risk.asp





PBR Methodology

- Risk Identification Process
- Economic Scenario Generation Process
- Financial Model Building Process
- Best Estimate Assumption Setting Process
- Appropriate Margins' Determination Process
- Risk Measurement Process
- Sensitivity Testing Process
- Documentation Process





Consumer Impact of Change

- Better Solvency Protection Awareness
- Price Changes in Products
- More Products available for Consumer
- More Competition among Companies
- First Step towards Principles-Based Products





Key Elements of Change

- Reserves & Capital – Calculation Methodology
- Collection of Company Experience Data
- Financial Statement Blank
- Accounting Practices & Procedures
- Standard Valuation Law (Revised)
- Financial Examinations and Legal Framework





Standard Valuation Law

- Law allows Valuation Standards to be established through an NAIC process
- Law requires collection of Experience Data
- Law continues to require Commissioner to cause valuations, examinations to determine compliance
- Law references Valuation Manual
- Manual contains details of Valuation
- Similar framework to Risk-Based Capital





Collection of Company Experience Data

- Mandatory for Principles-Based Valuation (Statute)
- Mortality, Morbidity, Lapses, Expenses, Premium Payment Patterns, Other Benefit Utilization Rates
- Provides Credible Data When No Credible Company Experience Exists
- Provides Regulatory Benchmarks to Evaluate Company Assumptions
- NAIC Needs to Determine Data Administrator & Funding





Financial Statement Blank

- Due & Deferred Premium Asset
- Advance Premiums
- Reserves Not Classified by Reserve Basis
- Change in Reserve Basis
- Changes to Income Statement
- Consider Additional Disclosures such as Margins





Accounting Practices & Procedures

- Classification of Product Types
- Accounting for Reinsurance
- Deficiency Reserves
- Unearned Premium Reserves
- Analysis of Increase in Reserves





PB Examination Process

- Examination is Primarily Prospective
 - What Could Happen in the Future
 - Results unique to specific risk profile of Company
 - Processes examined (subjective)
 - Reserve or Capital is in aggregate
 - Consistent with Risk Focused Financial Surveillance





2006 Examiners Handbook

An examination system should:

- Use examination resources as effectively and efficiently as possible
- Focus first on those insurers most likely to be the subject of significant actual or potential problems
- Use a risk analysis methodology to focus on the combined impact of the environment in which the company operates, the company's financial and operating results, and the extent and effectiveness of the company's internal controls



Goals/Objectives of PBA Framework to Address Certain Legal Issues



- Maintain Solvency
- Consistent Risk Measurement Methodology for Capital & Reserves
- Flexibility to Address Evolving Risks
- Auditable and Examinable
- Provides Consistency and Uniformity
- Provides Effective Resource Utilization



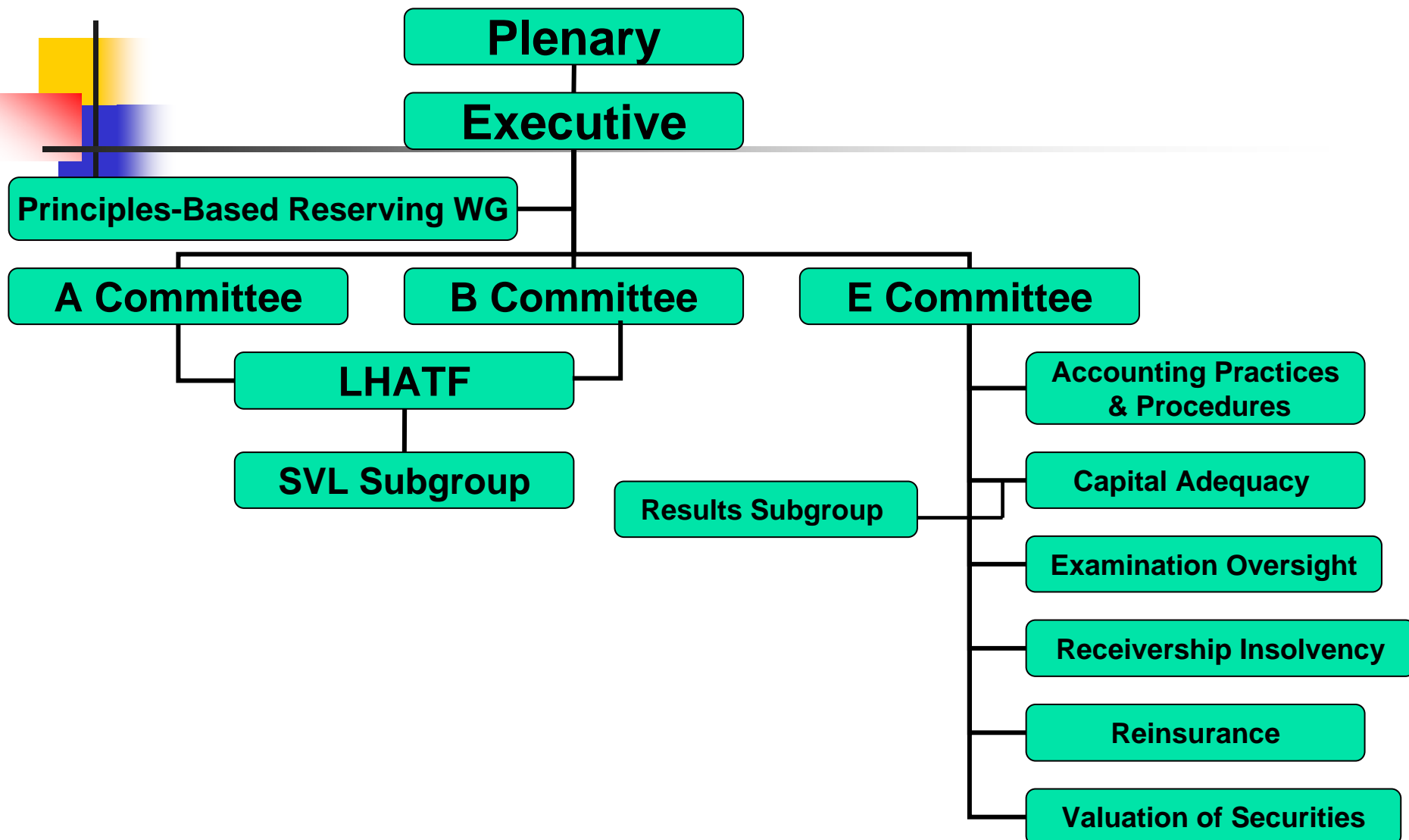


Current Legal Framework

- Standard Valuation Law
 - Statute, Regulations, Actuarial Guidelines
- Risk-Based Capital
 - Statute: References NAIC RBC Instructions
 - Regulations
- Financial Statement Filing
 - Statute: References NAIC Accounting Practices and Procedures Manual & NAIC Blanks
 - Regulations
- Examination of Financial Condition
 - Statute: References NAIC Examiners Handbook
 - Regulations: Annual Examination by Independent CPA



NAIC Committee Structure





Valuation Manual





Valuation Manual

- Goal of Valuation Manual is to enable uniform valuation requirements among states.
- Adoption of Valuation Manual may be similar to Accounting Practices & Procedures Manual.
- States would still retain control with the ability to alter any requirements in the Valuation Manual.





Valuation Manual Requirements

- Scope of Requirements Include:

- Reserve requirements

Current discussions include reserve requirements for all business both before and after the effective date of the manual.

- Actuarial opinions

Requirements as appropriate to address methods, risks, and assumptions in a principles-based environment.

- Reports

- Principles-Based Review requirements



Who is the Academy VLMT?



- 48 members, actuaries, non-actuaries, including a number of regulators.
- Members include actuaries involved with small, medium, and large companies.
- Members also include those knowledgeable of the Accounting Practices and Procedures Manual (APPM) and process.





VLMT Objectives

- Develop a draft of the Valuation Manual (VM) for NAIC LHATF consideration.
- Respond to LHATF requests in their deliberation of this manual.
- Provide input to LHATF on remaining issues regarding the changes to the Standard Valuation Law which enable principles-based reserves and enable state uniformity through the Valuation Manual.





How Can The VM Enable State Uniformity?

- Changes to the SVL allow an adopting state to follow the reserve requirements provided in the Valuation Manual.
- Some adopting states may be able to follow VM requirements when effective and as they change without needing to adopt by rule each year.
- Other states may need their version of the SVL to provide for adoption of the VM each year by rule and/or ability by rule to change VM requirements for their state.
- Such SVL variations may be needed to provide for appropriate state authority. However, uniformity will be encouraged to minimize any variations.





Current Direction of VM

- Inforce business on effective date of the VM would follow that state's requirements on that date with the exception of business that would be within the scope of VACARVM and would therefore follow those requirements.
- Business on and after the effective date of the VM for which new principles-based requirements have been adopted would follow those requirements.
- Business on and after the effective date of the VM for which new principles-based requirements have not been developed would follow VM requirements which would be based on NAIC requirements as of that date.





How will VM Requirements Coordinate With the APPM?

- It's envisioned that reserve requirements in Appendices A & C will be transferred from the APPM to corresponding appendices in the VM.
- The APPM will then reference as appropriate reserve requirements as found in the VM.
- Timing of the Valuation Manual and changes to the APPM will be worked so they are effective on the same date.





VLMT Approach For PBR Drafts

- Intend to incorporate model requirements in appropriate VM appendices but may combine similar principles-based sections and put these in one versus multiple places.
- May make suggested revisions based on review of drafts individually as well as together when put in the VM. Any revisions suggested would consider consistency with other principles-based requirements as well as clarity and efficiency.





Academy VLMT Subgroup Tasks Include the Following:

- Subgroup 1: Annual PBR review requirements and PBR reporting.
- Subgroup 2: Incorporating PBR and non-PBR requirements and any optional exemption or transition requirements for certain business including low-risk products.
- Subgroup 3: Experience reporting requirements.
- Input on ASOP considerations to be discussed across subgroups and entire VLMT.





Academy VLMT Coordination with NAIC LHATF

- Input provided to LHATF SVL2 Subgroup (Chaired by Larry Bruning, KS DOI). This subgroup is charged by LHATF for changes to the SVL and development of the Valuation Manual.
- Academy VLMT Report was provided to LHATF for the Winter NAIC 2006 Meeting in San Antonio.
- Will respond to any requests by LHATF and SVL2 Subgroup.
- Several members of the Academy VLMT are on both LHATF and the LHATF SVL2 Subgroup.





Projected Timing of SVL Changes and the VM

- March/September 2007: Possible NAIC Adoption of SVL Changes.
- Early 2007: Academy VLMT initial draft of Valuation Manual.
- September 2007: Academy VLMT substantive completion of Valuation Manual.
- March/June 2008: NAIC adoption of Valuation Manual.
- January 1st 2009 or 2010: Effective Date of Valuation Manual for adopting states.

