Regulatory Update

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Topics – NAIC & Texas

• Principle-Based Reserves (PBR)
• Life Actuarial (A) Task Force (LATF)
• PBR Implementation (EX) Task Force
• Emerging Actuarial Issues (E) Working Group
• 2012 IAR Rule
• Regulatory Reviews:
  ➢ Texas Risk-Focused Examinations
  ➢ Actuarial Opinion Reviews & Support
  ➢ Own Risk Solvency Assessment (ORSA)
Principle-Based Reserves (PBR)

- Status of State Legislative Adoptions
- Status of LATF Top 10 PBR Items
- Other PBR Implementation Efforts
Super Majority Vote Required For VM to Become Operative

VM becomes operative on January 1 following:

1) SVL legislative enactment by at least 42 of the 55 jurisdictions (50 States, American Samoa, American Virgin Islands, District of Columbia, Guam, and Puerto Rico); and

2) SVL legislative enactment by states representing greater than 75% of direct premiums written as reported in 2008 life accident & health, fraternal, and health annual statements; and

3) NAIC adoption of VM by 42 members or 75% of members voting, whichever is greater
## 2008 Direct Premium Percentages

**Source:** NAIC

<table>
<thead>
<tr>
<th>State</th>
<th>% Direct Premium</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York</td>
<td>9.20</td>
<td>100.00</td>
</tr>
<tr>
<td>California</td>
<td>6.79</td>
<td>90.80</td>
</tr>
<tr>
<td>Florida</td>
<td>6.77</td>
<td>84.01</td>
</tr>
<tr>
<td>Texas</td>
<td>6.27</td>
<td>77.24</td>
</tr>
<tr>
<td>All other states</td>
<td>70.97</td>
<td>70.97</td>
</tr>
</tbody>
</table>
State Legislative Adoption Status
Source: ACLI (10/28/2014)

- To date 18 states have adopted representing about 28% of the required premium volume.
- New Jersey’s bill is pending adoption.
- ACLI has indicated that 19 - 25 states have committed or are finalizing commitment to 2015 legislation
- State plans for the 2015 legislative session will be better known during November & December.
- ACLI numbers indicate a possibility of reaching the 42 state/75% premium threshold in 2015.
- An NAIC adoption of the small company exemption is expected to facilitate state legislative adoptions.
Complete in VM Prior to Operative Date

1. Complete the 2014 VBT (Early Summer 2015)
2. Provide CSO tables based on the 2014 VBT (Early Summer 2015)
3. Implement maintenance in line with adopted VM-20 process to annually update asset spreads and default costs in VM-20 (Fall 2014)
4. Accounting smoothing mechanism to address reserve volatility (Spring 2015)
5. Valuation Manual changes needed to support the experience data collection process in Section I of the PBR Implementation Plan (Spring 2015)
6. Governance revisions to section in VM-00 regarding process for VM updates - Completed
7. Commercial mortgage default costs (Spring 2015)
8. Additional small company considerations (Fall 2014)
9. Review of VM-31 documentation requirements (Spring 2015)
10. Definition of products included in VM-20 Section 3 (NPR) (Fall 2014)
Status: Top 10 Items

1. Complete the 2014 VBT (Early Summer 2015)
2. Provide CSO tables based on the 2014 VBT (Early Summer 2015)

Mary Bahna-Nolan, Chairperson, American Academy of Actuaries Life Experience Subcommittee, provided a report at the Summer LATF meeting. LATF exposed the 2014 VBT tables for comment through 10/15/14. The exposure includes the S&U tables but not the relative risk tables.

Significant testing is needed for completion of the 2014 VBT and 2014 CSO tables in order to achieve target dates.

The SOA has formed a Project Oversight Group (POG) to facilitate this testing effort.
3. Implement maintenance in line with adopted VM-20 process to annually update asset spreads and default costs in VM-20 (Fall 2014)
   - VM-20 spread tables updated to 12/31/13 adopted this past summer
   - NAIC close to finalizing steps for quicker turnaround and adoption of updates to spread tables and default cost tables
   - New Governance edits in VM-0 address process for these annual updates
4. Develop accounting smoothing mechanism to address reserve volatility (Spring 2015)
   - ACLI to provide a recommendation
   - Will coordinate with the Statutory Accounting Principles (E) Working Group

5. Valuation Manual changes needed to support the experience data collection process provided in the PBR Implementation Plan (Spring 2015)
   - LATF is monitoring and is to coordinate changes to VM-50 & 51 with the work on the experience data collection process being performed by the PBR Implementation (EX) Task Force
Status: Top 10 Items

6. Governance revisions to the section in VM-0 regarding the process for updating the Valuation Manual (COMPLETE)

ACLI to Provide Recommendations For The Following:

7. Commercial mortgage default costs (Spring 2015)
9. Review of VM-31 documentation requirements (Spring 2015)
   ➢ Review VM-31 documentation requirements and adjust as appropriate to support reporting and documentation needs
10. Definition of products included in VM-20 Section 3 (NPR) (Fall 2014)
   ➢ Definition will focus on products covered by Section 3.A.1, Net Premium Reserve, for term and universal life with secondary guarantees
8. Additional small company considerations (Fall 2014)

- LATF on its 10/23/14 call voted to recommend to the PBR Implementation (EX) Task Force the revised ACLI small company exemption but with a deferral to the Task Force to set the premium threshold level for what defines a small company given this is a policy decision. The premium threshold level originally submitted by ACLI was for a company with less than $300 million in ordinary life premium belonging to an NAIC group with less than $600 million in ordinary life premium. Information was submitted to the Task Force to help with this policy decision.

- The note to review continuance of the small company exemption within the first five years was removed. Besides the premium threshold level a company to be considered for exemption must have an RBC ratio of at least 450% of the authorized control level and must not have ULSG policies issued or assumed after the operative date of the Valuation Manual which do not meet the definition of a non-material ULSG product.

- The definition of a non-material ULSG product was simplified in prior discussions to contain only one cumulative premium type of secondary guarantee. Shadow secondary guarantees were removed from the definition.
LATF Non-PBR Work

- Academy AG 33 Non-Elective Incidence Task Force
  - There are two proposals which are to be discussed by LATF. One proposal essentially clarifies not to do something non-sensible regarding an elective benefit contingent on a non-elective event. The other proposal essentially requires the highest reserve be derived for this contingent elective benefit.

- 2015 GRET
  - LATF adopted the 2015 GRET. Higher expenses were reflected.

- Index-linked UL Illustrations
  - LATF exposed for comment two proposals, both in the form of an actuarial guideline. One is an ACLI proposal and the other is from a group of ACLI member companies referred to as the Coalition.
PBR Implementation (EX) Task Force

- Plenary
- Executive Committee
  - Principle-Based Reserving Implementation (EX) Task Force
  - Life Insurance and Annuities A-Committee
  - Health Insurance and Managed Care B-Committee
  - Financial Condition E-Committee
  - Financial Regulation Standards & Accreditation F-Committee
PBR Implementation Efforts Include:

- Training & Education
- Experience Reporting and Statistical Agent Process
- PBR Pilot Project
- Charges to various groups to prepare for PBR including charges to LATF to address tasks in the Valuation Manual prior to the operative date.
- Charges to develop PBR reporting requirements and review procedures.
  - PBR Review (EX) Working Group
    - PBR Review Procedures (EX) Subgroup
    - PBR Blanks Reporting (EX) Subgroup
XXX/AXXX Captive Framework

- High Level Description of Selected Framework Charges to Various NAIC Groups:
  - LATF was charged by the PBR Implementation (EX) Task Force to develop the Actuarial Method for the XXX/AXXX Captive Framework and include this method in a new actuarial guideline.
  - The Capital Adequacy (E) Task Force was charged to make appropriate RBC adjustments to support the Framework.
  - The Reinsurance (E) Task Force was charged to develop appropriate credit for reinsurance changes to models.
  - The Blanks (E) Working Group was charged to provide for appropriate disclosure.

- Interim PBR Implementation (EX) Task Force Meeting in DC on 11/6/14.
  - Verbal status report of results and next steps.
At the summer meeting the Working Group adopted the proposed interpretation relating to YRT reinsurance. This interpretation is to apply prospectively starting with year end 2014.

Other interpretations were exposed and discussed on the 10/30/14 call of the Working Group. These include AG 38, Section 8D questions relating to:

- Use of a hypothetical portfolio when asset information is not available
- Determination of the starting asset portfolio
- Delinkage of asset and liability cash flows

Besides addressing the AG 38, 8D exposures, the Working Group will work to address AG 38, Section 8E, ratio questions this fall.
2012 IAR Rule

- The NAIC Life Insurance and Annuities (A) Committee sent a letter to states at the beginning of this year to encourage adoption of the rule to apply to issues on and after 1/1/15.
- Texas adopted this rule at the beginning of the year to apply to issues on and after 1/1/15.
- ACLI has been working closely with other states to encourage similar adoption.
- Based on ACLI tracking as of 10/6/15 there were 14 states who have adopted, 13 who have rules pending, and around 6 who anticipate adopting.
Regulatory Reviews

- Texas Risk-Focused Examinations
- Actuarial Opinion Reviews & Support
- Own Risk Solvency Assessment (ORSA)
Risk-Focused Key Concepts

1. Flexibility of the Established Process
2. Initial Impact to Examination Timeframes/Scheduling
4. Responsibility to Consider Corporate Governance and Risk Management
5. Consideration of “Other than Financial” Risks
6. Utilization of External Auditor/Sarbanes-Oxley & Internal Audit Documentation
7. Confidentiality
8. Materiality
9. Utilization of Examination Results to Modify and Update the Insurer’s Priority Determination
Risk-Focused Surveillance Cycle

**Supervisory Plan**
- Develop Ongoing Supervisory Plan That Includes:
  - Frequency of Exams
  - Scope of Exams
  - Meetings with Company Management
  - Follow-Up on Recommendations
  - Financial Analysis Monitoring

**Examination**
- Risk-Focused Examination Seven Phase Process:
  - Identify Key Functional Activities
  - Identify/Assess Inherent Risk
  - Identify & Evaluate Controls
  - Determine Residual Risk
  - Establish Procedures and Conduct Exam
  - Update Supervisory Plan
  - Exam Report/Mgmt Letter

**Internal/External Changes**
- Consider changes to:
  - NAICRO Ratings
  - Ownership/Management/Corporate Structure
  - Business Strategy/Plan
  - CPA Report or Auditor
  - Legal or Regulatory Status

**Company Priority Score**
- Determined By:
  - Department analysis and NAIC financial analysis tools:
    - Scoring System
    - ATS Results
    - IRS Ratings
    - Exam Results

**Financial Analysis**
- Financial Analysis includes:
  - Risk Assessment Results
  - Financial Analysis Handbook Process
  - Ratio Analysis
  - Actuarial Analysis
  - Other Units (Market Regulation, Legal, etc.)
  - Update with internal/external changes
Exam Key Functional Activities and Phases 1 - 7

- Primary actuarial involvement in KFA’s covering:
  - Reserving (separate risk matrix for ‘Life’ and ‘A&H’)
  - Reinsurance (separate risk matrix for ‘Assuming’ and ‘Ceding’)
- More limited actuarial involvement in KFA’s covering:
  - Pricing / Underwriting
  - Investments
- Actuarial involvement by phase:
  - Phase 1 – Interview Key Actuarial Personnel
  - Phase 1 – Review CPA Actuarial Workpapers
  - Phase 3 – Review Controls
  - Phase 5 – Detail Testing (primarily on reported financial amounts as attested to within the Actuarial Opinion)
Actuarial Interview Sections

1. Experience and Background
2. Duties and Responsibilities
3. Reporting Structure
4. Ethics
5. Risk Areas
   - Inherent to his/her department (inaccurate valuation or pricing)
   - Inherent to products (mortality, interest, lapse, etc…)
6. Risk Mitigation Strategies (Internal Controls)
7. Other Topics, including PBR preparedness
Comprehensive Actuarial Memorandum that supports assumptions and methodologies used in:

1. Development of Reserve Calculations
2. Modeling of Asset Adequacy Analysis

ASOP No. 23 – Data Quality

§ 4.1.a “the actuary should disclose the source(s) of the data”

Consider establishing a Peer Review Process
Consider including documentation of valuation controls
Consider including discussion of “moderately adverse deviations” in actuarial assumptions (ASOP No. 22 § 3.3.2)
Texas will consider adoption of the ORSA bill during its 2015 legislative session.

A second pilot project underway to review a number of ORSA filings where Texas is the lead state on several of these.

The NAIC has recently adopted ORSA analysis and examination procedures which complement the current efforts to review the pilot ORSA filings.

Section II – Insurer’s Assessment of Risk Exposure
  - Stress Testing

Section III – Group Assessment of Risk Capital
  - Internal Capital Models
  - External Capital Models
  - Prospective Solvency Assessment
Questions / Comments

Selected NAIC Links:

PBR Implementation (EX) Task Force
http://www.naic.org/committees_ex_pbr_implementation_tf.htm

Life Actuarial (A) Task Force
http://www.naic.org/committees_a_latf.htm

Emerging Actuarial Issues (E) Working Group
http://www.naic.org/committees_e_emerging_actuarial_issues_wg.htm