|  |
| --- |
|  |
| LATF Exposure |
| PBR Questions for LATF Review |
|  |
| As discussed on the February 2 LATF call the Task force agreed to post the VM Review Group responses to the Q & A questions received from regulators and industry. The Group reviewed a list of almost 150 questions and identified around 40 questions for which they could provide responses that, in their collective opinion, are clear readings of the Valuation Manual. This exposure comprises the first 20 of the 40 questions. Please review the responses. The Task Force will receive comments including whether the responses go beyond providing clear readings of the Valuation Manual.  The Group acknowledges that the remainder of the 150 questions, those that were not identified as being subject to clear readings, may require Valuation Manual changes. Those changes are expected to be accomplished by the submission of amendment proposals to the Task Force. |
|  |
| Exposed for comment through March 10, 2017  Please send comments to RMazyck@NAIC.Org |

|  |
| --- |
| [Type the abstract of the document here. The abstract is typically a short summary of the contents of the document. Type the abstract of the document here. The abstract is typically a short summary of the contents of the document.] |

1. **Question:** Will there be any retroactive unlocking of Valuation Manual NPR assumptions in the future and will there be any corresponding effect on nonforfeiture?

**Response:** Retroactive unlocking of future changes to prescribed NPR assumptions is mentioned in two guidance notes (one is at the end of VM-20 Section 3.C.1., and the other is at the beginning of VM-20 Section 3.C.2). These guidance notes state that the intent is to require retroactive unlocking of changes to mortality and lapse assumptions, but not interest rate assumptions. However, these guidance notes do not provide guidance on how to unlock, and any decision to retroactively unlock mortality or lapse assumptions will be made in the future at the time when the prescribed assumptions are revised. At the time of any decision to retroactively unlock, a number of issues would need to be addressed. There will not be any retroactive unlocking of corresponding nonforfeiture assumptions since they are set by the policy at time of issue.

\_\_\_

2. **Question:** Do VM-G and VM-31 apply to policies that are excluded from the scope of VM-20, such as preneed policies and policies sold by companies that have been granted a companywide exemption?

**Response:** No.  The requirements of VM-31 or VM-G apply only to policies subject to principle-based valuation.  However, VM-G provides guidance on guidance on governance that could be beneficial to any line of business.  Note that VM-30 does apply to such policies.

 \_\_\_

3. **Question:** When do the first 2 rows of term NPR lapse table come into play given the rules above the table ((i-v) in b)?

**Response:** The NPR lapse table for term policies is a part of VM-20 Section 3.C.3.b.v. It is preceded by specified lapse rates in Section 3.C.3.b.i – iv. In Section 3.C.3.b.v., it is stated that the lapse table is to be used “for the first year following a rate increase…” and “…instead of what would otherwise apply from i through iv above”.

The first two rows of the table apply to a term policy whose level premium period is from 2 to 5 years (first column from the left).

 \_\_\_

4. **Question:** VM-20Section 3.C.3.b.i states that lapse rates for term shall be 10% per year during any level premium period of less than five years, except as noted in iii and iv.  VM-20 Section 3.C.3.b.iv states that lapse rates shall be 10% per year during any premium paying period after an initial level premium period of less than five years.  This doesn’t appear to be an exception to 3.C.3.b.i.

**Response:**  It is not an exception, since the rate in both cases is 10%.

\_\_\_

5. **Question:** In the event that a company wants to adopt 2017 CSO before moving to PBR, what requirements and hurdles would the company need to deal with?

**Response:**  The actions needed to implement the 2017 CSO table would be similar to the actions taken in the past of implementing a new CSO table such as the 2001 CSO table. This includes changes to valuation systems, potential impacts on pricing, NF testing, 7702 and 7702A calculations, and impact to tax reserves. Potential changes to policy filings may also be needed. However, as was the case in the past when changes to a CSO table were made, companies have a 3-year transition to implement these needed changes.

6. **Question:** When applying VM-20 to policy years when the valuation net premium exceeds the gross premium, is the DPA still based on the net premium and is a separate deficiency reserve required?

**Response:**  The determination of the DPA will be the same as under the current rules defined in SSAP 51 for term products.  A separate deficiency reserve is not required.

\_\_\_

7. **Question:** Is the length of a ULSG SG measured from date of issue or date of valuation and what requirements do a ULSG policy follow when the SG is no longer in force such as when the SG has expired?

**Response:**  The SG is measured from the date of issue. VM-20 Section 3.B.6.a explicitly states that after the end of the secondary guarantee period, VM-20 Section 3.B.5 applies. If a policy has a secondary guarantee, it follows VM-20 Section 3.B.5 and VM-20 Section 3.B.6.  The conditions are not stated in terms of the guarantee being in effect, but whether the policy includes a guarantee.  Policies do not go back and forth between standards – they qualify for one or the other by the terms of the contract.

\_\_\_

8. **Question:** Is there a materiality threshold for modeling reinsurance cash flows when doing the DR or SR calculations pre or post reinsurance?

**Response:**  VM-20 does not provide any separate or specific materiality threshold for modeling reinsurance cash flows. If reinsurance is present, omitting reinsurance cash flows from calculation of the post-reinsurance modeled reserves (that is, the deterministic and/or stochastic reserves) would be a simplification or approximation, which is addressed in VM-20 Section 2.G.

\_\_\_

9. **Question:** For companies using an unearned premium approach for term products, is the unearned premium always a pro rata net premium?

**Response:** The company will follow the current rules defined in SSAP 51 for term products. Accordingly, the unearned premium is always a pro rata net premium.

**1. Question:** Speaking of 2017 in particular, would it be correct to expect that at 12/31/17, the assets modeled in DR and SR (i.e. the ones purported to be the ones backing the PBR business) should consist of some subset of the assets the company acquired in 2017, and nothing that was acquired before that?

**Response:**  It is not necessary that only assets acquired in 2017 will back liabilities for business issued in 2017. VM-20, 7.D.1.b. states “For an asset portfolio that supports both policies that are subject and not subject to these requirements, the company shall determine an equitable method to apportion the total amount of starting assets between the subject and non-subject policies.” Actuarial judgment should be used to determine an equitable method of apportioning the starting assets. For example, if a company is using a portfolio method of allocating investment income to both subject and non-subject policies, there could be assets that were acquired prior to 2017 that support policies that are subject to PBR in 2017.

\_\_\_

**2. Question:** Can you have negative starting assets for the deterministic reserve calculation? If so, how should you handle modeling the negative assets?

**Response:** Yes there can be negative starting assets.  For example, this can happen when the projected premium and investment income exceed the projected future benefits and expenses where negative starting assets would be needed to result in the required zero ending asset amount at the end of the projection period.

Negative assets will generate negative investment income in the cash flow projections.   The negative investment income should be based on an appropriate borrowing rate, either an external borrowing rate or an internal borrowing rate that is certified by the duly authorized investment officer of the company as being consistent with the company’s investment strategy (see VM-31, section 3.D.12.a) and that reflects the company’s cost of borrowing where applicable (see VM-20, section 7.E.2).

\_\_\_

**3. Question**: What level of aggregation is required for the starting asset requirement?  Is it permissible to apply the collar at a more granular level than is required?

**Response:**   Per Section 7.D.2, the starting asset collar applies to all model segments in aggregate.   If it chooses to apply the collar at a more granular level, the company must demonstrate that the collar constraints are also met in the aggregate.

\_\_\_

**4. Question:** How is NPR calculated for a substandard policy? It appears from 9C6e that substandardness (e.g. Table A, or a $2 flat extra) is to be modeled in DR and SR. What is the impact of substandard ratings on the determination of the greatest of the three (NPR, DR, SR), and where exactly does the NPR piece of this go in the VM-20 Reserve Supplement blank?

**Response:** Under the current formulaic “pre-PBR” CRVM requirements, most companies report a separately calculated reserve for substandard risks in addition to the CRVM reserve. There was not an intention to change how substandard risks are reflected under the new PBR requirements. It is clear that the NPR for policies not subject to Section 3.A.1 (i.e. policies other than term policies and universal life policies with secondary guarantees) should use the same methods as were used in calculating CRVM reserves prior to the operative date. The NPR requirements for term and universal life with secondary guarantees make no mention of substandard risks. The prudent estimate mortality assumption used in calculating the deterministic and stochastic reserves should consider substandard risks and mortality. There is provision to make adjustments to the own company mortality assumption and industry table (Section 9.C.3) to account for the impaired/increased mortality. Since substandard extra is not explicitly addressed in the NPR calculation, a modification of Section 3 of VM-20 to specifically address this matter is under consideration for a future version of the Valuation Manual.

\_\_\_

**5. Question:** What is the source of the premium amount considered in the companywide exemption? If the premium amount includes a one-time large premium from acquisition that puts the company over the limit, should the company seek an exemption from the commissioner?

**Response:** Premiums are measured as direct plus reinsurance assumed from an unaffiliated company from the Ordinary Life line of business reported in Exhibit 1 Part 1 of the prior calendar year L & H annual statement. A one-time large premium would be included. The decision whether to seek an exemption from the domestic regulator is up to the discretion of the company.

\_\_\_

**6. Question:** If model segments are tied to a company’s segmentation plan, does this mean term or ULSG product groups could be modeled with the “other” life product group for purposes of determining the net investment earned rates?

**Response:**  Yes.

\_\_\_

**7. Question:** For a company using the mean reserve approach to calculate the NPR for term products, with a DPA asset, is the DPA asset at 12/31/17 automatically zero, by virtue of the fact that the year 1 net premium gets set to 0 in VM-20 and is there ever a circumstance when the “one-half premium” component is supposed to be based on the gross premium instead of the net?

**Response:** The company will follow the current accounting rules in SSAP 51 for term products. Accordingly, the 12/31/17 DPA asset will be zero and there is not a circumstance where the “one-half premium” is based on the gross premium instead of the net premium.

\_\_\_

**8. Question:** Does the unlocking (potential) for the mortality table apply to policies issued prior to the Company’s adoption of PBR for that block of business (i.e., policies not valued under VM-20) or only to policies issued on or after the company’s transition date for that block of business (i.e., policies valued under VM-20)?

**Response:** For each block of business within the scope of VM-20, the company must choose a transition date that is no later than 1/1/2020, for implementation of the VM-20 requirements. Only policies that are:

(a) subject to VM-20 (see exclusions in II Reserve Requirements, Life Insurance, B.); and

(b) issued on or after the selected transition date for that block,

will be subject to VM-20’s rules for re-setting (i.e. unlocking) the mortality assumption.

All other policies will be valued in accordance with the appropriate reference in VM-A or VM-C, which do not reference unlocking of the mortality assumption.

\_\_\_

**9. Question:** For mortality improvement, the “as-of” date of the Industry mortality table (2015 VBT) appears to be 1/1/2015. Is industry mortality to be based on 2015 VBT, 2015 VBT projected to 2017 or Unloaded CSO 2017?

**Response:**  According to VM-20, Section 9.C.3.a, the industry basic table to be used is to be based on the most recent valuation basic table listed in VM-M. Currently, this is 2015 VBT

Modifications of an industry basic table are permitted in a limited number of situations (Section 9.C.3.b). After any such modifications, mortality improvement may be applied, but only from the as-of date of the industry mortality table (currently 7/1/15 corresponding to 2015 VBT) up to the valuation date, but not beyond (Section 9.C.3.g).

\_\_\_

**10. Question:** For the grading period, we were going to stop grading at attained age 100 instead of the “later of the duration where: attained age is 100, or 15 years after the underwriting selection”. My thinking is that if the issue age is 86, then we shouldn’t grade to attained age 101. Does this seem okay?

**Response:** VM-20 requires grading based on sufficient data period and credibility as defined in 9.C.6.b.  If that grading extends to older ages, there is a further limit to stop the grading bythe later of attained age 100 or 15 years after underwriting.  Stopping grading earlier is not prohibited, but the insurer must still comply with the requirement of section 9.C.7.b that the resulting anticipated experience assumptions must be no lower than the mortality rates that are actually expected to emerge and that the company can justify.

\_\_\_

**11. Question:** If the Industry table is the 2015 VBT table and the maximum Qx is equal to 0.500 at attained age 110 and above, do you still need to apply the margin at this point? Can we cap the mortality rates at 0.500?

**Response:**  VM-20 requires margins at all attained ages (Section 9.C.5). The margins are defined by attained age in 9.C.5.b and 9.C.5.c, and specifically include margins at ages 106 and above.

\_\_\_