National Association of Insurance Commissioners

The Center for Insurance Policy and Research

**MEMORANDUM**

**TO:** Financial Regulation Standards and Accreditation (F) Committee

**FROM:** NAIC Staff

**DATE:** March 15, 2019

**RE:** Application of PBR to Fraternal Benefit Societies

At the 2017 Spring National Meeting, the Financial Regulation Standards and Accreditation (F) Committee adopted revisions to the Part A: Laws and Regulations (Part A), Liabilities and Reserves standard of the Financial Regulation Standards and Accreditation Program to include the 2009 revisions to the *Standard Valuation Law* (#820), commonly referred to as principle-based reserving (PBR). The original referral from the Life Actuarial (A) Task Force also included a recommendation to apply the standard to fraternal benefit societies (fraternals) when specifically referenced by the significant elements.

Fraternals are not currently included in Part A of the accreditation program. When the referral was discussed, the Committee agreed that fraternals should be included in relation to PBR. The revisions adopted to the accreditation standard, therefore, reflect inclusion of fraternals in the following significant element:

> "The *Valuation Manual* should be adopted by the states uniformly, utilizing the version effective Jan. 1, 2017, and all subsequent revisions adopted by the NAIC membership (including any provisions with respect to fraternal benefit societies). For policies issued on or after the operative date of the *Valuation Manual*, the standard prescribed in the *Valuation Manual* is the minimum standard of valuation in accordance with Section 11A."

To ensure consistency with this decision, the Part A Preamble of the *Accreditation Program Manual*, which defines the scope of the program, should also be updated.

We ask that the Committee consider the attached revision to the Part A Preamble to include fraternals in regard to the PBR standard, with an effective date of Jan. 1, 2020. This date aligns with the effective date of the PBR standard, which is also Jan. 1, 2020.

See the attachment for the proposed changes to the Part A Preamble. The initial referral, which includes the complete list of significant elements adopted by the Committee, is also attached for reference.

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# NAIC POLICY STATEMENT ON FINANCIAL REGULATION STANDARDS

## PART A: LAWS AND REGULATIONS

### Preamble for Part A: Laws and Regulations

### Purpose of the Part A Standards

The purpose of the Part A: Laws and Regulations standards are to assure that an accredited state has sufficient authority to regulate the solvency of its multi-state domestic insurance industry in an effective manner. The Part A standards are the product of laws and regulations that are considered to be basic building blocks for effective financial solvency regulation. A state may demonstrate compliance with a Part A standard through a law, a regulation, or an administrative practice that implements the general authority granted to the commissioner, or any combination thereof, which achieves the objective of the standard. The term "state" as used herein is intended to include any NAIC member jurisdiction, including U.S. territories. The term "commissioner" means commissioners, directors, superintendents or other officials who by law are charged with the principal responsibility of supervising the business of insurance within each state.

## Part A: Laws and Regulations – Excluding Risk Retention Groups Organized as Captives

### Scope of the Part A Standards (Excluding Risk Retention Groups Organized as Captives)

<u>Life/Health and Property/Casualty Insurers</u>
The following Part A standards apply to the regulation of a state's domestic insurers licensed and/or organized under its life/health and property/casualty statutes (life/health or property/casualty insurer), but only if the insurer is a multi-state insurer. NOTE: This section does not apply to a state's domestic insurers licensed and/or organized under its captive or special purpose vehicle statutes or any other similar statutory construct. For purposes of Part A, a life/health or property/casualty insurer that meets any of the following conditions is considered to be a multi-state insurer and subject to the Part A standards:

1) A property/casualty or life/health domestic insurer that is licensed in at least one state other than its state of domicile.

2) A property/casualty or life/health domestic insurer that is operating in at least one state other than its state of domicile.

3) A property/casualty or life/health domestic insurer that is accredited or certified as a reinsurer in at least one state other than its state of domicile.

4) A property/casualty or life/health domestic insurer that is reinsuring business covering risks residing in at least two states.

5) A property/casualty domestic insurer that is accepting business on an exported basis as an excess or surplus line insurer in at least one state other than its state of domicile.

Captive Reinsurers

---------------Detail Excluded to Conserve Space---------------

Other Types of Insurers

For clarity purposes, the scope of the Part A standards excludes regulation of those insurers licensed as fraternal ~~orders~~ benefit societies and title insurers, except that compliance with the "Liabilities and Reserves" standard is required for entities licensed as fraternal benefit societies where specifically referenced within the standard. The scope of the Part A standards also excludes regulation of health organizations, except that compliance with the "Capital and Surplus Requirement" standard is required for entities licensed as health organizations (including health maintenance organizations, limited health service organizations, dental or vision plans, hospital, medical and indemnity or service corporations, or other managed care organizations) to the extent the insurance department regulates such entities. This definition does not include an organization that is licensed as either a life/health insurer or a property/casualty insurer, which are subject to the full Part A accreditation standards.

National Association of Insurance Commissioners & The Center for Insurance Policy and Research

**MEMORANDUM**

TO: Financial Regulation Standards and Accreditation (F) Committee

FROM: Life Actuarial (A) Task Force

DATE: November 3, 2016

RE: Recommendation for Part A Accreditation Standards and Guidelines for 2009 Revisions to the *Standard Valuation Law* (#820)

**Executive Summary**

On Sept. 23, 2009, the Executive (EX) Committee and Plenary adopted revisions to the *Standard Valuation Law* (#820). These revisions authorize the use of the *Valuation Manual*, which contains the minimum reserve standards for all life insurance contracts, annuity and pure endowment contracts, accident and health contracts, and deposit contracts issued on or after the operative date of the *Valuation Manual*. The revisions also authorize a principle-based reserving (PBR) basis for those policies and contracts specified in the *Valuation Manual*, and provide requirements for the actuarial opinion of reserves with respect to these policies. The revisions further mandate that companies shall submit mortality, morbidity, policyholder behavior, or expense experience and other data as prescribed by the *Valuation Manual*. Finally, the *Valuation Manual* does not become operative until 42 states representing at least 75% of direct written premium adopt the 2009 revisions to Model #820.

Currently, only Section 3 (Actuarial Opinion of Reserves) and Section 4 (Computation of Minimum Standard) are significant elements under the accreditation standard for Model #820. On March 25, 2010, the Life and Health Actuarial Task Force submitted a memorandum to the Financial Regulation Standards and Accreditation (F) Committee that recommended that the following additional sections of Model #820 be considered significant elements:

- Section 3A—Actuarial Opinion Prior to the Operative Date of the *Valuation Manual*
- Section 3B—Actuarial Opinion of Reserves after the Operative Date of the *Valuation Manual*
- Section 4—Computation of Minimum Standard
- Section 11—*Valuation Manual* for Policies Issued on or After the Operative Date of the *Valuation Manual*
- Section 12—Requirements of a Principle-Based Valuation
- Section 14—Confidentiality

The Committee released the recommendation for adoption of the 2009 revisions to Model #820 as an accreditation standard for a preliminary public comment period of 30 days, and for a one-year public comment period from Jan. 1, 2011, to Dec. 31, 2011. On March 3, 2012, the Committee voted to re-expose the recommendation through the end of 2012, in order to permit work to be completed on the *Valuation Manual*, which the NAIC membership later adopted on Dec. 12, 2012. In both 2013 and 2014, the Committee voted to waive its normal procedures and defer action on the accreditation standard in order to observe developments in the state PBR implementation process. On March 28, 2015, the Committee voted to send a referral to the Principle-Based Reserving Implementation (EX) Task Force to reconsider the appropriateness of the significant elements originally recommended to the Committee in 2010, which was then referred to the Life Actuarial (A) Task Force for further development.

On June 10, 2016, the Executive (EX) Committee and Plenary adopted the recommendation of the Principle-Based Reserving Implementation (EX) Task Force that: 1) 45 states, representing 79.5% of the appropriate premium volume have adopted Model #820, or legislation including substantially similar terms and provisions; and 2) those states that have enacted the revised Model #820 should take any necessary action to use Jan. 1, 2017, as the operative date for the *Valuation Manual*.

With the *Valuation Manual* operative date determined, the Life Actuarial (A) Task Force recommended the attached proposed significant elements to the accreditation standard with respect to the 2009 revisions to Model #820 on Sept. 29, 2016. It is further the recommendation of the Life Actuarial (A) Task Force that this revised accreditation standard for Model #820 become effective as of Jan. 1, 2020, which is the date that PBR generally becomes applicable to all companies after a three-year phase-in under VM-20, Requirements for Principle-Based Reserves for Life Products, of the *Valuation Manual*.

**A statement and explanation of how the potential standard is directly related to solvency surveillance and why the proposal should be included in the standards:**

Currently, insurers use a formula-based static approach to calculate reserves for products. However, insurance products have increasingly grown in complexity, which has led to a need for a new reserve method. The NAIC membership's adoption of the revisions to Model #820 in 2009 introduced a new method for calculating life insurance policy reserves. This new method, PBR, supplements the current formulaic approach to determining policy reserves with an approach that more closely reflects the risks of highly complex products. The improved calculation is expected to "right size" reserves; i.e., reduce reserves that are too high for some products and increase reserves that are too low for other products.

The *Valuation Manual* is established by Model #820 and would be used to detail the reserve calculation requirements. The *Valuation Manual* defines a process to facilitate future changes in valuation requirements on a more uniform, timely and efficient basis. The goals of the NAIC membership in developing the *Valuation Manual* are:

1. To consolidate into one document the minimum reserve requirements for life insurance, accident and health insurance, and deposit-type contracts pursuant to Model #820, including those products subject to principle-based valuation requirements and those not subject to principle-based valuation requirements.
2. To promote uniformity among the states' valuation requirements.
3. To provide for an efficient, consistent and timely process to update valuation requirements as the need arises.
4. To mandate and facilitate the specific reporting requirements of experience data.
5. To enhance industry compliance with Model #820 and subsequent revisions, as adopted in various states.

**A statement as to why ultimate adoption by every jurisdiction may be desirable:**

The formulaic approach prescribed by current state laws and regulations needs to be frequently updated as new product designs are introduced. PBR alleviates this need to a great degree. State laws would establish principles upon which reserves are to be based—rather than specific formulas—with more detail and constraints included in the *Valuation Manual*. Current formulas do not always accurately reflect the risks or the true cost of the liability or obligations of the insurer. For some products, this leads to excessive conservatism in reserve calculations and, for others, it results in inadequate reserves. The current system locks in certain assumptions, resulting in reserves that do not change as economic conditions change or as insurers accumulate actual experience. The new system adjusts reserves as economic conditions change and as insurers accumulate credible experience.

**A statement as to the number of jurisdictions that have adopted and implemented the proposal or a similar proposal and their experience to date:**

Model #820 is currently an accreditation standard and the significant elements have been adopted in substantially similar form by all NAIC-accredited jurisdictions. On Nov. 21, 2015, the Principle-Based Reserving Implementation (EX) Task Force adopted the *Plan to Evaluate Substantially Similar Terms and Provisions to Determine the Valuation Manual Operative Date*, in order to determine whether Model #820, as amended by the NAIC membership in 2009, or legislation including substantially similar terms and provisions, has been enacted by at least forty-two (42) of the applicable fifty-five (55) NAIC-member jurisdictions. As part of the plan, on Jan. 29, 2016, the states received a survey to document their current conformance and deviations in the state's Standard Valuation Law from Model #820. The NAIC Legal Division and a group of state general counsels completed a legal review of the state survey responses, and determined that the following 46 states (the original 45 states plus Pennsylvania, which adopted PBR after the initial NAIC recommendation) have currently adopted the 2009 revisions to Model #820, or legislation including substantially similar terms and provisions: Alabama; Arizona; Arkansas; California; Colorado; Connecticut; Delaware; Florida; Georgia; Hawaii; Idaho; Illinois; Indiana; Iowa; Kansas; Kentucky; Louisiana; Maine; Maryland; Michigan; Minnesota; Mississippi; Missouri; Montana; Nebraska; Nevada; New Hampshire; New Jersey; New Mexico; North Carolina; North Dakota; Ohio; Oklahoma; Oregon; Pennsylvania; Rhode Island; South Carolina; South Dakota; Tennessee; Texas; Utah; Vermont; Virginia; Washington; West Virginia; and Wisconsin.

**A statement as to the provisions needed to meet the minimum requirements of the standard. That is, whether a state would be required to have "substantially similar" language or rather a regulatory framework. If it is being proposed that "substantially similar" language be required, the referring committee, task force or working group shall recommend those items that should be considered significant elements:**

The current accreditation standard for Model #820 requires state adoption on a substantially similar basis. In addition, the 2009 revisions to Model #820 requires that, in order for the *Valuation Manual* to be operative, the 2009 revisions to Model #820, or legislation including substantially similar terms and provisions, has been enacted by at least forty-two (42) of the applicable fifty-five (55) NAIC-member jurisdictions. Therefore, the Life Actuarial (A) Task Force recommends that the attached proposed significant elements for Model #820 be adopted by NAIC-accredited jurisdictions in a "substantially similar" manner, as that term is defined in the Accreditation Interlineations of the NAIC Financial Regulation Standards and Accreditation Program.

**An estimate of the cost for insurance companies to comply with the proposal and the impact on state insurance departments to enforce it, if reasonably quantifiable:**

The NAIC and the states, as well as the life insurance industry, have recognized that there would be significant costs associated with moving to a principle-based approach to reserving. To this end, the *Principle-Based Reserving (PBR) Implementation Plan*, dated March 7, 2016, provides a framework for PBR implementation, and contains specific guidance on creating a reporting and regulatory review process, including: 1) conducting a PBR Pilot Program; and 2) coordinating the development of financial analysis, examination and actuarial review procedures, as well as evaluating the actuarial staff resource requirements of the NAIC and the state insurance departments. It also provides guidance on a Company Experience Reporting Framework.

The NAIC and the Society of Actuaries (SOA) have also undertaken to attempt to quantify the costs and impacts from the implementation of PBR. The *Report on the Results of the Principle-Based Reserving State Resource Survey* by the Principle-Based Reserving Implementation (EX) Task Force, dated April 6, 2013, was issued with the intent of capturing the status of insurance department resources, as they exist today, and given their current understanding of PBR requirements, the jurisdictions expectations of the impact of PBR implementation. In June 2015, the SOA and NAIC jointly issued the *Mortality and Other Implications of Principle-Based Reserving (PBR) Survey – Part 1*, which provides an overview of the current state of the industry's preparedness for implementing PBR. In October 2016, the NAIC and SOA also jointly issued the *2016 Mortality & Other Implications of PBR (VM-20) Survey – Part 2*, which was designed to provide a more in-depth assessment of the current state of the industry's preparedness for implementing PBR.

In summary, the estimate for costs for insurance companies to comply with the 2009 revisions to Model #820 adopting PBR, and the impact on state insurance departments to enforce it, is a currently evolving process, and the costs associated with this process are not readily quantifiable at this time. The NAIC continues to work on this issue.

**Any Other Matters:**

The proposed significant elements would specifically require the states to apply the *Valuation Manual* to fraternal benefit societies. The current Preamble for Part A provides: "For clarity purposes, the scope of the Part A standards excludes regulation of those insures licensed as fraternal orders and title insurers." If the Committee believes it is appropriate for Model #820 to apply to fraternal benefit societies for accreditation purposes, it would be necessary to amend the Part A Preamble in order to include any reference with respect to fraternal benefit societies in the proposed significant elements.

**Proposed Significant Elements for 2009 Revisions *to Standard Valuation Law* (#820)**

a. The following definitions under Section 1B apply on or after the operative date of the *Valuation Manual*: appointed actuary; company; policyholder behavior; principle-based valuation; qualified actuary; and *Valuation Manual*?

b. Policies and contracts issued prior to the operative date of the *Valuation Manual* are annually valued in accordance with Section 2A?

c. Policies and contracts issued on or after the operative date of the *Valuation Manual* are annually valued in accordance with Section 2B?

d. Prior to the operative date of the *Valuation Manual*, every life insurance company doing business in this state shall annually submit an actuarial opinion on reserves in accordance with Section 3A?

e. After the operative date of the *Valuation Manual*, every company with outstanding life insurance contracts, accident and health insurance contracts, or deposit-type contracts in this state shall annually submit the opinion of a qualified actuary in accordance with Section 3B(1)?

f. After the operative date of the *Valuation Manual*, every company with outstanding life insurance contracts, accident and health insurance contracts, or deposit-type contracts in this state, except as exempted by the *Valuation Manual*, shall annually submit an opinion of the qualified actuary with respect to the Actuarial Analysis of Reserves and Assets Supporting Reserves in accordance with Section 3B(2)?

g. After the operative date of the *Valuation Manual*, a memorandum in form and substance acceptable to the commissioner shall be prepared to support each actuarial opinion in accordance with Section 3B(3)(a)?

h. After the operative date of the *Valuation Manual*, the commissioner may engage a qualified actuary at the expense of the company to review the opinion and the basis for the opinion and prepare the supporting memorandum required by the commissioner in accordance with Section 3B(3)(b)?

i. Every opinion after the operative date of the *Valuation Manual* shall be governed by the requirements of the provisions of Section 3B(4)(a) through Section 3B(4)(d)?

j. Prescribe computation of minimum standard for reserves similar to Section 4?

k. With respect to accident and health insurance contracts issued on or after the operative date of the *Valuation Manual*, the standard prescribed in the *Valuation Manual* is the minimum standard of valuation required in accordance with Section 10?

l. The *Valuation Manual* should be adopted by the states uniformly, utilizing the version effective Jan. 1, 2017, and all subsequent revisions adopted by the NAIC membership (including any provisions with respect to fraternal benefit societies). For policies issued on or after the operative date of the *Valuation Manual*, the standard prescribed in the *Valuation Manual* is the minimum standard of valuation in accordance with Section 11A?

m. Any changes to the *Valuation Manual* are made in accordance with Section 11C?

n. The *Valuation Manual* is required to specify all the requirements described in Section 11D?

o. The commissioner may require a company to change any assumption or method that, in the opinion of the commissioner, is necessary in order to comply with the requirements of the *Valuation Manual* or Model #820, and the company shall adjust the reserves as required by the commissioner in accordance with Section 11G?

p. Provisions providing that a company must establish reserves using a principle-based valuation that meets conditions similar to those in Section 12A for policies or contracts as specified in the *Valuation Manual*?

q. Provisions providing that a company using a principle-based valuation for one or more policies or contracts specified in the *Valuation Manual* shall establish procedures for corporate governance and oversight of the actuarial valuation function in accordance with Section 12B?

r. With respect to policies in force on or after the operative date of the *Valuation Manual*, provisions providing that a company shall submit mortality, morbidity, policyholder behavior, or expense experience and other data as prescribed in the *Valuation Manual* similar to Section 13?

s. Prescribes confidentiality provisions similar to Section 14?

t. Although not required for accreditation, a state's laws and regulations may allow an exemption from the reserving requirements of the *Valuation Manual* similar to that provided in the *Valuation Manual*. For such cases, the laws and regulations contain provisions that are similar to those provided in the *Valuation Manual*?

- If state law or regulation allows an exemption from the reserving requirements of the *Valuation Manual* based on certain parameters (such as insurer premiums or categories of insurers), please provide the citation. If state law or regulation does not allow for this, please indicate such by including "N/A" in the reference column.