

# Actuarial Statutory Accounting

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- Principles-Based Reserving Project
- Deferred Premium Asset and Unearned Premium Reserve
- VA CARVM
- Life RBC – C-3 Phase III
- Miscellaneous Updates
- NAIC Consideration of IFRS
- Model Audit Rule Adoption and Implementation Guide

### Principle-Based Reserving for Life and Health Companies

- Work still continues on a comprehensive project to develop principle-based reserves for life insurance, annuities & certain health insurance products
- Objective is to develop reserving requirements that can be applied to ever-changing products without the need to constantly develop and/or revise the related laws, regulations and actuarial guidelines
- Would replace Standard Valuation Law with set of principles
- Allows for actuarial judgment
- Would require companies to use “prudent estimate”

## Principle-Based Reserving for L&H Companies

- Likely to involve stochastic analysis for many products
- Could involve a combination of formulas and other analyses
  - Formulas used as a floor (and potentially for FIT)
- Independent review of an actuary's work
  - Now being considered by the Principle Based Working Group (EX)
  - Considering relying on CPA firm's work

### Principle-Based Reserving for L&H Companies

- Requires changes to SVL
- Valuation Manual Concept will allow NAIC to change requirements without going through SVL change
  - Will contain detailed reserve instructions for calculating PBR
- Goal of Valuation Manual
  - Allow valuation changes to be adopted quickly and uniformly among the states
  - Similar to APP Manual adoption and changes thereto
  - Still allow states to alter any requirements in the Valuation Manual
- Unclear as to whether states legislatures will allow delegation of reserve rule-making authority to the NAIC

## Statutory Accounting and Regulatory Developments

# Principle-Based Reserving for L&H Companies

## Current Timeline per LHATF

- Significant effort by NAIC at Winter 2007, Spring 2008 and Summer 2008 NAIC meetings to discuss Valuation Manual and revised SVL
- Significant issues still remain under discussion, including
  - Discount rates
  - Reserve credit for dynamic hedging
  - Allowable reinsurance
- NAIC has given an additional 3 months to complete the work
- For 2010 adoption, LHATF will need to adopt SVL and VM at its September meeting to meet the 2009 state legislative calendars

## Statutory Accounting and Regulatory Developments

# Principle-Based Reserving for L&H Companies

## Alternative Timeline

- Significant member of LHATF have been unavailable for significant proportions of 2008
- Timeline requires exposure of the SVL and VM to all regulators before adoption
- Some state legislators are on a two year cycle
- More realistic adoption could be between 2013 and 2015

### Deferred Premium Asset and Unearned Premium Reserve

- When reinsurance premiums are paid in full upfront and policyholder pays on an installed basis, companies might record a deferred premium asset and a reinsurance reserve credit greater than the reserves
- Resulting in a “temporary” surplus
- ACLI proposed a new Form A
  - The ceding entity shall reduce its deferred premium to account for any deferred premiums that arise from its own model premium payments to the reinsurer
  - DPA and UPR will be calculated with the lesser of the gross premiums or valuation net premiums
  - Expected to apply to all policies issued from Jan 1, 2009 with business issued before this date being “grandfathered”



## Statutory Accounting and Regulatory Developments

### Variable Annuity CARVM

- Started in 2002 and though super ceded PBR follows many of the same principles
- Still in draft six years later
- Will replace AG39 and apply retrospectively, and is currently stated to be effective in 2008
- LHATF currently focused on PBR so little progress made since September 2007
- VA CARVM might get some traction at the September 2008 meeting

### Life RBC – C-3 Phase III

- Purpose of C-3 Phase 3 is to develop a principles-based approach to the determination of the C3 (interest rate risk) component and a portion of the C1 (asset risk) component of Risk-Based Capital for individual life products, including individually underwritten life certificates.
  - Essentially the same as C-3 Phase II but for Life insurance
  - C-3 Phase II is for variable annuities
- Working Group meets by phone but hasn't meet for 3 months and little progress made in the last 6 months
- Earliest likely adoption to be for 2009 Annual Statements

## Statutory Accounting and Regulatory Developments

### Miscellaneous Updates

- LHATF to develop a guideline, consistent with the Standard Non forfeiture Law, for cash values on term insurance with return of premium
- Academy expects to issue a report later this year on Non forfeiture law for life insurance products (separate to PBR)
- Net Level Premium tax reserves
  - Separate basis for tax reserves that uses prescribed mortality tables
  - Lower than the XXX requirements
- Valuation Mortality Tables and Margins
- New York State looking to implement the data submission requirements (VM50 and VM51) for YE 2008

## NAIC Consideration of IFRS

- NAIC has devoted significant resources to monitoring international accounting issues – more than those devoted to US GAAP
- NAIC has formed new group International Solvency and Accounting Working Group
  - Charges include IASB and FASB's joint convergence project
  - Reviewing and commenting on IASB insurance accounting issues
- NAIC has commented on IASB Insurance Contracts drafts
- Alignment with principles-based reserving (PBR) uncertain

## Statutory Accounting and Regulatory Developments

### Final Adoption of Model Audit Rule

- Adoption effective 2010
- Insurers with \$500 million in annual written premium will be required to file annually a Management Report on Internal Control Over Financial Reporting (No Auditor Attestation is required)
- Independent Audit Committee members will be required for many entities
- Provisions apply at the legal entity level but introduces concept of "Sox Compliance Entity"
- Allows domiciliary commissioner to provide exemption to "any or all" provisions

## Statutory Accounting and Regulatory Developments

# Model Audit Rule – Management’s Report of Internal Control over Financial Reporting

### What the report includes

- Statement that management is responsible for establishing and maintaining adequate internal control over financial reporting;
- Statement that management has established internal control over financial reporting and an assertion, to the best of management’s knowledge and belief, after diligent inquiry, as to whether its Internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles;

## Statutory Accounting and Regulatory Developments

# Model Audit Rule – Management’s Report of Internal Control over Financial Reporting

### What the report includes

- Statement that briefly describes the approach or processes by which management evaluated the effectiveness of its Internal control over financial reporting;
- Statement that briefly describes the scope of work that is included and whether any internal controls were excluded;
- Disclosure of any unremediated material weaknesses in the Internal control over financial reporting identified by management as of December 31 immediately preceding.

## Statutory Accounting and Regulatory Developments

# Model Audit Rule – Management’s Report of Internal Control over Financial Reporting

### What the report includes

- A statement regarding the inherent limitations of internal control systems; and
- Signatures of the chief executive officer and the chief financial officer (or equivalent position/title).

### When is the report due?

- Annually, sixty days from the filing of the audited financial statements
- First report will be filed in 2011



## Statutory Accounting and Regulatory Developments

### Model Audit Rule – Management’s Report of Internal Control over Financial Reporting

- “SOX Compliant” entities will file their or their parent’s 404 Report and an addendum stating that the internal controls of the insurer or Group of insurers having a material impact on the preparation of the insurer’s or Group of insurers’ audited statutory financial statements were included in the scope of the Section 404 Report.
- For internal controls with a material impact on statutory f/s which are outside the scope of the Section 404 report, the insurer must file a Section 16 report that covers those internal controls.
  - Will it be common for Sox Compliant entities to file an addendum?

## Statutory Accounting and Regulatory Developments

### Model Audit Rule – Requirements for Audit Committees

#### Audit Committee requirements

- Sox Compliant Entities are exempt from the audit committee requirements of the Model Audit Rule
- Therefore, no AC is required at the legal entity insurance company level with independent AC members
- Audit Committee of registrant satisfies AC requirements

## Model Audit Rule – Implementation Guide

- Interested Parties and NAIC have developed an Implementation Guide
  - Additional guidance for companies on topics
    - “Group of insurers”
    - Management attestation including detailed sample reports
    - Transition when premium threshold is reached
    - Audit partner rotation

## Model Audit Rule – Implementation Guide

- Definition
  - “Group of insurers” means those licensed insurers included in the reporting requirements of the Insurance Holding Company System Regulatory Act or a set of insurers as identified by management, for the purpose of assessing the effectiveness of Internal control over financial reporting.
- Concept is used for both establishing the level at which the internal control work will be performed and at what level the Audit Committee will function
  - Goal was to avoid having to issue Management Reports and have ACs for each statutory legal entity

## Statutory Accounting and Regulatory Developments

### Internal Control Reporting 2007-2009

- Adoption of changes to MAR does not change IC reporting until 2010
- Therefore, unremediated SDs and MWs still be reported to the state 2006 through 2009
- REMINDERS
  - Six states do not allow 60 days from the filing of the audited f/s to report SDs, MWs and remediation plan; they are the same states that also require the NMW letter
    - Idaho, Illinois, Florida, Maine, New York, North Carolina, Puerto Rico, and Vermont (captive insurers only)
  - Remaining states (except MA) allow the extra 60 days.

# QUESTIONS?



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