PBR Reinsurance and Life Subgroups

These two subgroups had back-to-back calls today to discuss section VM-20 of the Valuation Manual.

Reinsurance
This subgroup spent its entire allotted time in a spirited discussion of risk transfer. The Academy has recommended eliminating current risk transfer rules and relying on PBR modeling.

Some regulators (NY, FL and CA) opposed that idea for these reasons:

- It is hard to model every provision of current treaties,
- Reinsurance data are sometimes incomplete,
- Assumptions can be subjective,
- Public policy should not allow “slicing and dicing” risks to reduce reserves without reducing overall risk, and
- Modeling is open to manipulation.

Industry responded by comparing reinsurance modeling to that of basic coverage:

- Cash flow models for reinsurance are just as good,
- Reinsurance assumptions are no more subjective,
- Cash flows for reinsurance are just as predictable, and
- “Slicing and dicing” actually helps companies manage risks effectively.

As time expired, neither side had moved from its original position.

Life
This subgroup had its own long and spirited discussion on prescribed net spreads on reinvestment assets, also with little ultimate movement of positions:

- The Academy proposed a method to derive spreads based upon four bond classes, with adjustments for type, quality and term of other asset classes,
- NY strongly favors the original proposal of using risk-free rates plus spreads for illiquidity,
- NY would accept a flat percentage over Treasuries but opposes spreads varying by asset class,
- NY argued that that spreads net of default should be the same for all bonds,
- Industry rebutted the last point by noting that additional spreads over Treasuries have not been offset by actual defaults for many bond classes,

- Everyone seemed to agree that if either net invested assets or net investment earnings are negative in a scenario, then discount rates should be risk-free rates and not net asset earned rates.

The subgroup spent a short time on other items:

- It agreed to put the Academy's proposal on the stochastic exclusion test into VM-20. The test, outlined in prior meetings, involves 12 scenarios and a criterion for passing the test, but details are not final, and the full LHATF body still has to approve it.
- The Academy recommended using one CTE level for all products. LHATF will consider it, but still reserves the right to vary CTE by product type.

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