

## PBR Default Costs

The Life Reserve Working Group (LRWG) reported the status of its project to develop a prescribed asset default cost method for VM-20. At the December meeting, LHATF and LRWG discussed the key elements of the method for determining seriatim asset ratings, baseline default cost tables, historical spreads, and maximum net spread adjustments.

LRWG will provide the following items at the March meeting:

- A re-write of VM-20 containing the method, including the elements cited above,
- A summary of changes from the November LRWG report, and
- An analysis of implied margins, compared to both the Canadian approach and the cost of capital approach.

By the end of June, LRWG will provide a study of reserve volatility resulting from the method, and a possible alternate method for prescribed reinvestment spreads.

LRWG cited 4 issues to consider in the evaluation of the default proposal:

- The appropriate level of conservatism,
- The potential for volatility,
- The degree of complexity, and
- The sources of data for baseline default costs and historical spreads.

The proposed method does not apply to fixed income assets without NAIC designations. NY had agreed in December to derive a method for such assets. NY proposed that the default assumption be such that the net yield is capped at 104% of the appropriate Treasury yield curve, taking into account the date of asset purchase and its maturity structure, plus 25 basis points. LHATF accepted this proposal.

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